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No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1982

Esther C. Dickman, Estate of Paul B. Dickman, Deceased, G. Wendell Smith, Personal Representative,

Petitioners,

vs.

Commissioner of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Do the gift tax statutes require taxation of interest-free loans?

2. Assuming transactions between related parties, is the opportunity to use another's property or money subject to gift taxation regardless of how (or if) that opportunity is exploited?

3. At what point in tax administration should the Commissioner of Internal Revenue seek judicial solutions, as opposed to solutions by regulations or by legislation?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

The undersigned counsel, on behalf of Esther C. Dickman and G. Wendell Smith, Personal Representative of Estate of Paul B. Dickman, deceased, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (App., infra, 1a-10a) is attached in the Appendix. The official citation is not available at this time; the 11th Circuit docket number is 81-5297. The opinion of the United States Tax Court (App., infra, 11 a-15a) is reported (CCH) 41 TCM 620.

JURISDICTION

The judgment of the Court of Appeals was entered on November 1, 1982. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254 (1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

26 U. S. C. §2501(a) (1) imposes a gift tax:

"... on the transfer of property by gift..."

26 U. S. C. §2511(a) provides:

"...the tax...shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible..."

26 C. F. R. §25.2511-1(c) provides:

"Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or devise employed, constitutes gifts subject to tax."

No other statutory or regulatory provisions, other than the foregoing, very general, provisions can be reasonably interpreted as affecting the issues of this case.

STATEMENT OF THE CASE

Jurisdiction in the United States Tax Court was properly invoked by Taxpayers' petition in response to the Commissioner's assessment and statutory notice. After judgment for taxpayers, the Commissioner perfected the appeal to the U. S. Circuit Court of Appeals. The Eleventh Circuit reversed and remanded for valuation of the "gifts" by the Tax Court.

Decision by the Eleventh Circuit in this case directly conflicts with the decision of the Seventh Circuit in *Crown v. Commissioner,* 585 F.2d 234 (1978) and with the United States Tax Court (67 T.C. 1060, 1977). The opinion in this case notes this direct conflict.

This conflict between the Circuits will create years of litigation if this Court does not use its authority to settle this question of imputed interest. The United States Tax Court, national in scope, will honor this case only in Florida, Georgia and Alabama (*Golsen v. Commissioner,* 54 T.C. 742 @757, aff'd. 445 F.2d 985, 10th Cir., 1971, Cert. Denied 404 U. S. 940 (1971). Taxpayers in all other states will still have the benefit of the Tax Court's position and the Commissioner will obviously avoid cases in the 7th Circuit area while seeking another Circuit to agree with the Eleventh and disagree with the Seventh.

This question of imputed interest is an important question of federal gift tax law if only on the facts of this case and *Crown*. However, as noted by the Seventh Circuit in *Crown* the broader

ramifications of this issue are tremendous in scope since only recently has the Commissioner contended the use of property (as opposed to the conveyance of property) falls under the very general words of the gift tax code. Indeed the decision in this case by the Eleventh Circuit goes further still. Since the Court treats the use (if any) of the money loaned as irrelevant, Dickman stands for gift taxation of the opportunity to use property -- whether utilized or not! The ramifications, reaching into all conceivable family relations, are endless.

Respectfully submitted,
S/S FRANK P. RIGGS

Frank P. Riggs
Counsel of Record

CERTIFICATE OF SERVICE

I hereby certify that, in accordance with Rule 28.5(b) of this Court, that on December 17th, 1982 I mailed (by U. S. Postal Service) three copies of this petition to Solicitor General, Department of Justice, Washington, D.C. 20530 and three copies to John F. Murray, Att.: Farley Katz, Esquire, Tax Division, Department of Justice, Washington, D.C. 20530, both mailings bearing sufficient first class postage and properly addressed.

S/S FRANK P. RIGGS

Frank P. Riggs

APPENDIX

Esther C. DICKMAN, Estate of Paul B. Dickman, Deceased, G. Wendell Smith, Personal Representative, Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellant.

No. 81-5297.

United State Court of Appeals,
Eleventh Circuit.

Nov. 1, 1982.

Action was brought challenging gift tax deficiencies assessed by the Commissioner of Internal Revenue. The Tax Court ruled against the Commissioner, and the Commissioner appealed. The Court of Appeals, James C. Hill, Circuit Judge, held that taxable gifts resulted when lenders made interest-free loans to their son and a corporation owned by lenders, their son and his wife and children.

Reversed and remanded.

Fay, Circuit Judge, filed concurring opinion.

Internal Revenue 4200

Taxable gifts resulted when lenders made interest-free loans to their son and a corporation owned by lenders, their son and his wife and children. 26 U.S.C.A. §§2501(a)(1), 2511(a), 2512(b).

Appeal from the Tax Court of the United States.

Before GODBOLD, Chief Judge, HILL and FAY, Circuit Judges.

JAMES C. HILL, Circuit Judge:

At issue in this case is whether taxable gifts resulted when lenders made interest-free loans to a relative and to a closely held corporation. The Tax Court ruled that all loans here were on a demand basis and, following its decision in *Crown v. Commissioner,* 67 T.C. 1060 (1977), *aff'd,* 585 F.2d 234 (7th Cir. 1978), it held that the loans involved no gift tax consequences. We reverse, holding that such interest-free loans are subject to the gift tax whether the loans are made for a fixed term or are on a demand basis; we remand for further proceedings relevant to the taxpayers' challenge to the gift tax deficiencies assessed by the Commissioner.

I. THE FACTS

Paul B. Dickman (now deceased) and Esther C. Dickman were husband and wife, and Lyle C. Dickman (also deceased) was their son. Artesian Farm, Inc. is a Florida corporation which was owned by Paul, Esther, Lyle, and Lyle's wife and sons.[1]

Paul ("decedent") and Esther made substantial loans to Lyle and Artesian during the calendar quarters involved here.[2] With two exceptions, all the loans were evidenced by non-interest bearing demand notes. One exception was a loan made to Lyle on "open-account" and payable on demand. The other was one made to Artesian; the parties dispute its characterization as a term or a demand

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1. The stock in Artesian Farm was owed as follows:

	Total		Voting Common		Non-Voting Common	
	Shares	Percent	Shares	Percent	Shares	Percent
Paul B. Dickman *	370	9.02	170	20.74	200	6.08
Esther C. Dickman	100	2.44	98	11.96	2	.06
Lyle C. Dickman	678	16.54	236	28.78	442	13.48
Margaret R. Dickman	702	17.12	79	9.63	623	19.00
Paul R. Dickman	750	18.30	79	9.63	671	20.46
Edward L. Dickman	750	18.29	79	9.63	671	20.46
Glenn K. Dickman	750	18.29	79	9.63	671	20.46
TOTAL	4,100	100.00	820	100.00	3,280	100.00

*Includes non-voting stock held indirectly through 100 percent stock-ownership of a corporation which owned stock of Artesian.

2. The oustanding loan balances at the end of each calendar quarter for the loans made by the decedent were as follows:

Calendar Quarter Ending	Lyle	Artesian Farms
March 31, 1971	$144,715.87	$374,650.00
June 30, 1971	144,715.87	374,650.00
September 30, 1971	144,715.87	300,578.00
December 31, 1971	144,715.87	300,578.00
March 31, 1972	144,715.87	669,733.00
June 30, 1972	144,715.87	669,733.00
September 30, 1972	144,715.87	669,733.00
December 31, 1972	144,715.87	669,733.00
March 31, 1973	225,615.87	457,641.00
June 30, 1973	225,615.87	457,641.00
September 30, 1973	225,615.87	457,641.00
December 31, 1973	225,615.87	457,641.00

loan.[3] After an audit, the Commissioner determined that the loans made by the decedent and Esther resulted in taxable gifts to the extent of the value of the use of the money lent.[4]

March 31, 1974	225,615.87	356,806.00
June 30, 1974	225,615.87	356,806.00
September 30, 1974	225,615.87	420,515.00
December 31, 1974	225,615.87	420,515.00
March 31, 1975	277,915.87	420,515.00
June 30, 1975	277,915.87	420,515.00
September 30, 1975	342,915.87	471,454.00
December 31, 1975	342,915.87	471,454.00
March 31, 1976	342,915.87	471,454.00
June 30, 1976	342,915.87	471,454.00
September 30, 1976	342,915.87	207,875.00
December 31, 1976	342,915.87	207,875.00

During the same period reflected in the above table, the outstanding balance of loans from Esther at the end of each calendar quarter was $226,130.05 to Lyle and $68,651.02 to Artesian.

3. The Commissioner has contested the Tax Court's decision that the loan was on a demand basis. We decline to reach that issue, for it is not absolutely clear at this point what difference the characterization will make since we hold that both term and demand loans produce taxable consequences. While the Commissioner did increase the assessed deficiency after determining that the loan was for a fixed term, *see infra* note 5, that does not crystallize the issue because there has been no judicial review of his valuation methods in this case. On remand, the Tax Court will be presented with the valuation issue; because the distinction and differences will be more fully developed after the Tax Court's consideration of that issue, the controversy concerning the characterization of the loan to Arteisan will be ripe for appellate review at that time.

4. In determining the amount of the gifts, the Commissioner applied the following interest rates to the loan balance outstanding during each taxable quarter:

Period	Interest Rate
Jan. 1, 1971-June 30, 1975	6 percent
July 1, 1975-Jan. 31, 1976	9 percent
Feb. 1, 1976-Dec. 31, 1976	7 percent

The interest rates used were the same as those established under § 6621, Internal Revenue Code of 1954, as made applicable by § 6601 to underpayments in tax. The various interest rates were applied according to the amount outstanding on loan during each of the periods established under § 6621.

Statutory notices of gift tax deficiency were issued for each of the calendar quarters ending March 31, 1971, through December 31, 1976; the total amounts were $41,109.78 for Esther and $42,212.91 for the decedent. Esther and the decedent's estate ("taxpayers") sought redetermination of the deficiencies by filing petitions with the Tax Court on November 28, 1978. By amended answers, the Commissioner asserted a greater deficiency for one of the quarters.[5]

The Tax Court found that all loans were demand loans indistinguishable from those in *Crown v. Commissioner*, 67 T.C. 1060 (1977), *aff'd*, 585 F.2d 234 (7th Cir. 1978). Relying on the opinions in *Crown*, the court held that the loans did not involve taxable gifts so that the taxpayers were not liable for the asserted deficiencies.

II. THE APPLICATION OF THE GIFT TAX PROVISIONS

A. The Reach of the Gift Tax

Section 2501(a)(1) of the Internal Revenue Code of 1954 imposes a gift tax on any "transfer of property by gift" made by an individual during the taxable year. Section 2511(a) provides that the tax should apply "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." Section 2512(b) helps define the phrase "transfer of property by gift:"

> Where the property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar quarter.

The present gift tax provisions were enacted by the Revenue Act of 1932. The Congressional Committee reports reflect Congress' intent to reach any gratuitous transfer of any interest in property:

> The terms "property," "transfer," "gift," and "indirectly" are used in the broadest and most comprehensive sense; the term "property" reaching every species of right or interest protected by law and having an exchangeable value.
>
> The words "transfer ... by gift" and "whether ... direct or indirect" are designed to cover and comprehend all transactions

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5. The amended answers were based upon the Commissioner's determination that a loan to Artesian was a term loan rather than a demand loan.

(subject to certain express conditions and limitations) whereby and to the extent ... that property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment.

H.R. Rep. No. 708, 72d Cong., 1st Sess. 27-28 (1932), *reprinted* in 1939—1 Cum. Bull. (Pt. 2) 457, 476; S. Rep. 665, 72d Cong., 1st Sess. 39 (1932), *reprinted* in 1939—1 Cum. Bull. (Pt. 2) 496, 524.

The Treasury Regulations embody the same expansive notion:

Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

Treas.Reg.§ 25.2511—1(c), 26 C.F.R. (1981).

On several occasions, the Supreme Court has indicated that the gift tax provisions should be applied broadly to effectuate the clear, sweeping intent of Congress. For example, in *Commissioner v. Wemyss,* 324 U.S. 303, 65 S. Ct. 652, 89 L.Ed. 958 (1945), the Court held that when an individual made a transfer to his prospective wife to compensate her for trust income she would lose upon their marriage, the transfer was a taxable gift even though it was not motivated by donative intent. The Court stated that "Congress intended to use the term 'gifts' in its broadest and most comprehensive sense" and acknowledged "the evident desire of Congress to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech." *Id.* 324 U.S. at 306, 65 S.Ct. at 654. *See also Smith v. Shaughnessy,* 318 U.S. 176, 180, 63 S.Ct. 545, 547, 87 L.Ed. 690 (1943) ("The language of the gift tax statute 'property ... real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent."); *Robinette v. Helvering,* 318 U.S. 184, 187, 63 S.Ct. 540, 542, 87 L.Ed. 700 (1943) (The purpose of the gift tax was to "reach every kind or type of transfer by gift.").

B. The No-Interest Loan as Property

Several court decisions have held that the right to use property for a predetermined, definite period of time constitutes "property" for tax purposes. *E.g., Threlfall v. United States,* 302 F.Supp. 1114, 1118-19 (W.D. Wis. 1969) (involving term leasehold and charitable

contribution deduction under income tax); *Allen v. Commissioner*, 57 T.C. 12 (1971) (same). Other cases have held that the right to use property for an indefinite period is "property." *E.g., Abbott v. United States*, 74—2 U.S.T.C. ¶ 13,040 (S.D. Miss. Nov. 14, 1974) (involving gift tax valuation and the right to use property for the life of another person); *Thriftimart, Inc. v. Commissioner*, 59 T.C. 598, 615—16 (1973), *remanded on other issues* (9th Cir. 1975) (involving charitable deduction and lease terminable by owner upon sale of building); *Passailaigue v. United States*, 224 F.Supp. 682, 686 (M.D.Ga. 1963) (involving charitable contribution deduction under income tax and the right to use real estate for such time as the owner permitted) ("Property is composed of constituent elements and of these elements the right to use the physical thing to the exclusion of others is the most essential and beneficial."); *Sullivan v. Commissioner*, 16 T.C. 228, 231 (1951) (involving charitable deduction and right to use property for duration of war).

Based on the reasoning of the previous cases, the Commissioner contends that the gift tax statute must be read to encompass the right to use hundreds of thousands of dollars interest-free for extended periods of time—the right transferred without consideration by the taxpayers to Lyle and Artesian. The Commissioner recognizes that the taxpayers reserved the right to demand repayment of the sums lent, and thus retained dominion and control over the money. However, he points out that since Lyle and Artesian received the right to use the money in the taxable periods involved here, they received the beneficial enjoyment of the transferred property, which, under the Regulations, constitutes a taxable gift to the extent of the value of that right. *See* § 25.2511—2(f), Treas. Reg. (1981), providing that in the case of a transfer of property which is an incomplete gift because the donor retains dominion and control, the "receipt of income of other enjoyment of the transferred property by the transferee" during the period before the gift is complete "constitutes a gift of such income or of such other enjoyment taxable as of the calendar quarter ... of its receipt."

The taxpayers admit the extremely broad import of the language found in the gift tax provisions and the relevant legislative history. They argue, though, that non-gift tax concepts of property are inapplicable and that the gift tax statute "has never been extended to the point of taxing the use of property without more than continued,

withdrawable permission." Appellees' Brief at 5. With special reference to the *Crown* decisions, the taxpayers argue that their position is reflected in other courts' application of the gift tax statute to non-interest-bearing loans. We turn then to those cases and other related ones.

III. OTHER COURTS, OTHER CASES

A. Bargain Exchanges Involving Term Loans

In *Blackburn v. Commissioner*, 20 T.C. 204 (1953), the taxpayer transferred property worth $245,000 to her children for a 30-year secured promissory note in the amount of $172,517.65, bearing interest at 2.25%. At that time, the usual rate of interest for a similarly secured note was 4%. The taxpayer conceded that the difference between the value of the property transferred and the face amount of the note was a gift. The issue presented was whether a gift resulted from the transfer of property worth $172,517.65 for a note in that exact amount but bearing a below-market interest rate. The Tax Court held that it was, and that the amount of the gift was the difference between $172,517.65 and the note's fair market value, which reflected a discount because of its low interest rate.

The same reasoning was applied in *Estate of Berkman v. Commissioner*, 387 T.C.M. (CCH) 183 (1979). There the decedent made five loans to his daughter, her husband and their controlled corporation during the years from 1968 to 1972. The loans were each evidenced by a promissory note, with the principal payable in a "balloon" at the end of 20 years. None of the notes was secured. On Mr. Berkman's death in 1974, none of the loans had been repaid. The Commissioner argued that the difference between the amount lent and the value of the notes, discounted to reflect their below-market interest rate, gave rise to a taxable gift. The Tax Court agreed that the loans were not arms-length transactions, and therefore any "difference between the amount of each transfer and the fair market value of each promissory note given in exchange constitutes a taxable gift." *ID.* at 186.

These cases would appear to require gift taxation when a non-interest-bearing term note is used to secure a loan. The taxpayers argue, though, that they lend no guidance here simply because they

involved bargain exchanges. We find that the taxpayers' efforts to distinguish the principles underlying those cases are unavailing; the cases suggest that the transfers here resulted in taxable gifts to the extent that the value of property transferred exceeded the value of the notes given in return by Artesian and Lyle.

B. Demand Loans

It is here that the taxpayers can point to direct authority for their position. The Commissioner has been totally unsuccessful in persuading courts that a taxable gift occurs when money is loaned for no interest and is subject to repayment on demand. The courts have explicitly or implicitly justified their results on the differences between demand and term loans.

The first decision on this issue was *Johnson v. United States*, 254 F.Supp. 73 (N.D. Tex. 1966). There, the taxpayers had made a series of non-interest-bearing loans to their two adult children during each of the years in issue, and the IRS attempted to impose a gift tax on the value of the use of the money on loan during each year. The court held that there were no taxable gifts, finding that the taxpayers had no right to interest, either express or implied, on the loans made to their children. The court stated:

> The time has not yet come when a parent must suddenly deal at arms-length with his children when they finish their education and start out in life. There is no legal requirement, express or implied, to charge them interest on money advanced to them at that stage, whether it be to open a law office and hang out a shingle, to go into the oil business on a substantial scale, or to begin life on their own in some other way.

Id. at 77.

We believe that the court's analysis missed the point of the issue before us. There is, of course, no legal requirement that parents charge their children interest on loans; there is likewise no legal requirement that parents charge for any property they might choose to transfer to their children. An owner is free to use or not to use his property, and there are no tax implications from the failure of an

owner to make the highest and best use of such property. However, if an owner does transfer property for less than full consideration, that does constitute a taxable gift.

The other reason given in *Johnson* to support its holding was the conclusion that if the loans went untaxed that would not permit the taxpayers to avoid estate tax by reducing their estate. *Id.* The court reasoned that had the taxpayers not made the loans, they were under no duty to invest the money. Thus, the court apparently believed the loans only reduced the taxpayers' potential estates (*i.e.*, including the interest they might have charged) rather than their actual estates. The loans in *Johnson,* just as in this case, could in fact reduce the taxpayers' actual estates, since the value of a lender-decedent's right to repayment of a loan, whether on demand or after a definite period, may well be worth less than face. A discount for collectibility, as well as for the delay in repayment, would be entirely possible. "if an individual makes a loan for one year and receives a note calling merely for the repayment of the principal, and if such individual then dies, the amount includable in his estate is the discounted value of the note, which is less than the amount transferred by the decedent." *Crown v. Commissioner,* 67 T.C. at 1069—70 (Simpson, J., dissenting). The imposition of the gift tax here would thus bolster the estate tax.[6]

We conclude, therefore, that *Johnson* rests on erroneous premises and reasoning. *See generally, e.g.,* O'Hare, *The Taxation of Interest-Free Loans,* 27 Vand.L.Rev. 1085 (1974); *Westover, Gift Taxation of Interest-Free Loans,* 19 Stan.L.Rev. 870 (1967); 65 Mich.L.Rev. 1014, 1018 (1967).

In *Crown,* a majority of the Tax Court, with four judges dissenting, indicated its agreement with *Johnson.* The taxpayers in *Crown,* like the taxpayers here, gave close family members the right to use large sums of money indefinitely, until such time as they might demand repayment. The Commissioner asserted that the taxpayers made gifts equal to the fair market value of that property, the value being measured by the interest that would have been charged in

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6. As the Seventh Circuit has recognized, the Commissioner's position also effectuates another purpose of the gift tax—protection of the income tax. *See Crown,* 585 F.2d at 236.

arm's length transactions for similar loans. The Tax Court viewed the "crux of the matter" as being the fact that the Commissioner "only recently has begun to assert that the making of non-interest-bearing loans is a taxable event, even though the statutory authorities offered in support of that position have been in existence since their creation of our income and gift tax laws." 67 T.C. at 1063. As the dissenting judges noted, however, such considerations do not justify the result reached in *Crown*:[7]

> It is well settled that the Commissioner may, even retroactively, change an earlier incorrect interpretation of the law applied by him. *Dixon v. United States*, 381 U.S. 68[, 85 S. Ct. 1301, 14 L.Ed.2d 223] (1965); *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180[, 77 S.Ct. 707, 1 L.Ed.2d 746] (1957). It is not altogether certain that the interpretation urged by the Commissioner in this case is entirely new, but even if it is, he is certainly free to correct his prior mistakes and apply the gift tax to those transactions coming within the statutory definition. Though the majority is shocked by the consequences of applying the law to some family transfers, they overlook the fact that this case involves not the usual family transfer, but over $15,000,000. Furthermore, many of the family transfers to which the majority refers would not be subject to tax because of the annual exclusion of § 2503(b). The statute clearly shows that Congress desired a

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7. The Commissioner also contests the legitimacy of the *Crown* majority's concerns:

> The courts in Crown failed to recognize that there are cases going back to 1953 where the Commissioner contended, and courts held, that interest-free or low interest loans result in gifts. See *Blackburn* and *Mason* [*v. U. S.*, 513 F.2d 25, 7th Cir.] both *supra*. Although these cases happened to involve term loans, they clearly imply the same result for interest-free demand loans. In addition, Treasury Regulations Gift Tax (1954 Code), Section 25.2511—2(f) (26 C.F.R.), the relevant language of which dates to 1936 (Treas.Reg. 79 (Rev.Act of 1932), Art. 3 (1936)), requires that interest-free demand loans result in gifts to the extent of the value of the money lent. In any event, it is well settled that the Commissioner may change his incorrect interpretation of the law, and may even do so retroactively. Finally, even if this "taxpayer reliance" argument were otherwise of greater merit, it would not be persuasive in the instant case, since several of the loans involved were made after the issuance in 1973 of Revenue Ruling 73—61, [1973—1 Cum.Bull. 408].
>
> Appellant's Brief at 39—40 (cross-references, certain citations and a footnote omitted).

broad application of it, and if an application of the statute as written produces questionable results, those situations should be brought to the attention of Congress.

Id. at 1070 (Simpson, J., dissenting).

The Seventh Circuit's decision in *Crown*, 585 F.2d 234, also totally rejected the Commissioner's theories. The court did note that a demand loan could be considered as "an outright gift of a 'property right'—namely the right to use the money for an indefinite period," *id.* at 239, which it analogized to a "tenancy at will" with respect to real property. However, the court felt that the right to use money embodied in a demand loan did not fit within the language of the Congressional Committee reports quoted *supra:*

> [W]e have seen no authority suggesting that the recipient of a loan payable on demand has a legally protectible interest vis-a-vis the lender. Moreover, the Commissioner has produced no evidence showing that the borrower's "at will" interest has an exchangeable value. Even if the theoretical existence of the possibility of an exchangeable value were conceded, ... the imputation of interest in subsequent time periods is seriously deficient as a measure of that value as of the time of the loan.

585 F.2d at 239.

We believe that this reasoning is contrary to other tax cases involving the right to use property for an indefinite period. Those cases establish that an "at will" interest is property, notwithstanding the absence of any rights vis-a-vis the transferor. Additionally, the recipient of a loan payable on demand would have a right with an exchangeable value; the borrower would be free to turn around and transfer that property right to another. For example, Lyle could have lent to a third party, at an arm's length interest rate, the money on loan to him, to be repaid on demand, which would be made when demand was made on Lyle's loan. How much the second borrower might be willing to pay for such a loan would probably be dependent upon how long he was able to retain use of the money lent. The Commissioner proposes to value the no-interest demand loans to Lyle and Artesian in precisely the same manner.

The Commissioner argued before the Seventh Circuit that the gift could be viewed as occurring continuously during the period that the loan is outstanding and as being completed only to the extent that the lender continues to refrain from demanding repayment. The court noted that this view of the gift "is in harmony with the Commissioner's formula for measuring the amount and timing of the gift." *Id.* at 240. However, the court apparently believed that this changed the concept of the gift being considered, and that the gift tax statute would not reach such a gift; it stated, "To characterize the mere use of property as a transfer of a property right implies a broader concept of what constitutes a property right under the gift tax laws than has heretofore been recognized." *Id.* (Footnote omitted).

We disagree with the Seventh Circuit's reasoning. The gift being considered does not change merely because it is valued upon "completion" of the gift each quarter. The right to use money is the property right being transferred; the period of use of that property—the length of time the donee is given the property right—is merely the means of valuing the property. *See Crown*, 67 T.C. at 1069 (Simpson, J., dissenting).

In sum, for the reasons set forth, we are unpersuaded by the views of other courts that have faced the issue before us.[8] We believe that the gift tax statute requires a different result.[9]

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8. In the situation before us, the taxpayers transferred the right to use money to a relative and a closely held corporation, thus implicating the gift tax. If the same transfer had been made by a corporation to an employee, the income tax would have been the relevant area of inquiry; *Martin v. Commissioner*, 649 F.2d 1133 (5th Cir. 1981), dealt with such a situation and held that the use of funds from an interest-free loan to a taxpayer does not constitute a taxable benefit. That precedent does not preclude our conclusion that taxable gifts occurred here. To the contrary, we find that the rationale of *Martin* and of the other income tax cases in this area suggests that the gift tax would applicable.

In *Martin*, the Fifth Circuit adopted the rationale of *Dean v. Commissioner*, 35 T.C. 1083 (1961). The *Dean* the Tax Court decided that an interest-free loan "results in no taxable gain to the borrower" and that "the Commissioner is not entitled to any increased deficiency based upon this issue." *Id.* at 1090. It seems, however, that the *Dean* court did not simply hold that the interest-free loans failed to produce income. Instead, the holding was based upon the peculiar income tax treatment of interest payments. If the receipt of an interest free loan is

IV. CONCLUSION

We hold that gratuitous interest-free loans do have gift tax consequences.[10] Our conclusion is compelled by the gift tax statute as it is illuminated by its legislative history, established treasury regulations, judicial interpretation, and the policy considerations underlying it. Remaining for consideration in this case is the value of the taxable gift that resulted when the taxpayers made interest-free loans to a relative and to a closely held corporation.[11] The case is remanded for proceedings not inconsistent with this opinion.

REVERSED and REMANDED.

FAY, Circuit Judge, concurring:

Taxpayers have given away no property, no interests and no rights but surely they have made a gift. Judge Hill has labored hard

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taxed because it is the equivalent of the payment of additional income by which to obtain the loan(*i.e.*, with which to pay interest), then a deduction based on the payment of that interest would also be available.

In *Greenspun v. Commissioner*, 72 T.C. 931 (1979, the Tax Court explained and reaffirmed the *Dean* rationale:

> In short, by excluding from gross income the clear economic benefit realized upon the receipt of a low- or no-interest loan to a shareholder or employee, in *Dean* we properly sought to place such a transaction on a tax parity with interest-bearing loans accompanied by an increase in dividends and salary.

Id. at 950. Under the gift tax statute, as under the income tax provisions, the "clear economic benefit" of a no-interest loan is recognized. However, unlike the income tax provisions, the gift tax statute provides no special treatment for the interest that would have been paid had the donor given cash used to obtain a loan. No offset is available to a lender, thus the taxpayers, having conferred an economic benefit upon the borrowers, must pay the gift tax that is a consequence of the transaction.

9. The conclusion that interest-free loans, whether term or demand, result in taxable gifts has received strong support from the commentators, who have sharply criticized the holdings of both the Tax Court and the court of appeals in *Crown*. *See, e.g.*, H. Dubroff and D. Kahn, *Federal Taxation of Estates, Gifts and Trusts*, ¶ 20.02 (3d ed. 1980); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation*, ¶ 10.01[2][f] at 10—10 & S 10—1 to S10—2 (4th ed. 1978 & Supp. 1 1981); K. Carey, *Interest Free Loans and the Gift Tax: Crown v. Commissioner*, 38 Ohio St.L.J. 903, 907—916 (1977). Joyce & Del Cotto, Interest Free Loans: *The Odyssey of a Misnomer*, 35 Tax L.Rev. 459, 468—469, 489—490 (1981).

to find some "legal support" for this conclusion. When one lets another use large sums of money for no charge, who would doubt that there has been conferred a valuable gift? The fact that the receipt given for the money is a demand note makes no difference.

Some would label the result in the Tax Court "poetic justice." The Commissioner is struggling against the web that government lawyers have been weaving for years. Tax laws are different; literal application is required—common sense is irrelevant and inappropriate. Only on this occasion, the "harsh result" denies the government revenue quite justly due.

Feeling that courts should avoid "slavish" interpretation of the Code and that the taxpayers in this instance are the ones relying on a "crabbed reading" of the words used by Congress[1], I join with Judge Hill. Any other result makes no sense.

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10. Taxpayers urge that our holding will create administrative problems and personal burdens due to its extension to a multitude of situations. It cannot be denied that taxes do create problems and burdens. Yet taxpayers' apprehensions may be greater than warrented. The Internal Revenue Code includes a de minimis provision which excludes from gifts transfers of relatively small value. Code Section 2503(b) provides that a taxpayer may make gifts to any number of persons of any amounts up to $3,000 each without incurring any gift tax liability. In addition, should a taxpayer make a gift during one year worth more than $3,000 to any one person, that taxpayer would not incur any gift tax liability until he has exhausted his credit under Section 2505.

11. Of course, we express no view on the valuation aspects of this case, such as the interest rates applied by the Commissioner.

1. See *Rickey v. U. S.*, 592 F.2d 1251, 1258 (5th Cir. 1979).

[CCH Dec. 37,512(M)] **Esther C. Dickman v. Commissioner. Estate of Paul B. Dickman, Deceased, G. Wendell Smith, Personal Representative v. Commissioner.**

Docket Nos. 13156-78, 13173-78. T. C. Memo. 1980-575. Filed December 30, 1980. [Appealable, barring stipulation to the contrary, to CA-5.—CCH.]

[*Code Sec. 2503*]

[Gift tax: Taxable gifts: Intrafamily interest free loans. *Held:* Interest free loans from parents to their son and a family corporation on open account or evidenced by demand notes do not give rise to taxable gifts. *Crown v. Commissioner* [Dec. 34,331], 67 T. C. 1060 (1977), aff'd. [78-2 USTC ¶ 13,260] 585 F.2d 234 (CA-7, 1978), followed.

Frank P. Riggs and Guy S. Emerich, for the petitioners. Roger D. Osburn, for the respondent.

Memorandum Findings of Fact and Opinion

DRENNEN, Judge: Respondent determined deficiencies in petitioners' Federal gift taxes as follows:

Taxable Period	Estate of Paul B. Dickman	Esther C. Dickman
1971 1st qtr.	$ 712.04	$ 706.97
2d qtr.	1,432.03	1,437.11
3d qtr.	1,258.24	1,256.37
4th qtr.	1,978.23	1,976.37
1972 1st qtr.	1,195.38	1,177.57
2d qtr.	1,810.43	1,792.62
3d qtr.	1,862.91	1,845.09
4th qtr.	2,582.90	2,565.10
1973 1st qtr.	941.13	932.47
2d qtr.	1,661.12	1,652.48
3d qtr.	1,661.12	1,652.47
4th qtr.	2,381.12	2,372.48

1974 1st qtr.	845.08	771.66
2d qtr.	1,636.20	1,491.66
3d qtr.	1,750.33	1,593.27
4th qtr.	2,537.84	2,313.26
1975 1st qtr.	1,065.81	967.40
2d qtr.	1,853.30	1,687.41
3d qtr.	3,108.81	2,828.46
4th qtr.	3,896.30	3,808.34
1976 1st qtr.	1,859.81	1,846.90
2d qtr.	1,945.29	1,881.51
3d qtr.	922.39	1,108.01
4th qtr.	1,315.10	1,444.80

By amended answer respondent alleges that there were greater taxable gifts and greater gift tax deficiencies than originally determined for the first calendar quarter of 1972 of each of the petitioners. Because of the nature of the disputed item which gave rise to this claim for greater deficiencies and the manner in which the gift tax is computed, the gift tax deficiencies for all calendar quarters subsequent to the first calendar quarter of 1972 would also be affected if respondent's allegation is sustained.

Due to certain stipulations by the parties,[1] the principal issue for decision is whether taxable gifts resulted from interest free loans made by Paul B. Dickman and petitioner Esther C. Dickman to their son and to a closely-held corporation. In the event it is concluded that taxable gifs were made, subsidiary issues of valuation and whether the gifts were of present or future interests must be decided.

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1 The parties have stipulated that petitioners are entitled to the "split gift" provisions of section 2513, I. R. C. 1954, except that net gifts made either by Paul B. Dickman to petitioner Esther C. Dickman or by petitioner Esther C. Dickman to Paul B. Dickman by virtue of gifts being made to a closely-held corporation do not qualify for this split gift provision. Effect was given to this stipulation in determining the gift tax deficiencies. In determining the deficiencies for some of the periods involved, respondent erred by allowing annual exclusions for gifts of certain future interests and by making certain mathematical mistakes. The parties have stipulated that these errors can be corrected in connection with any computations to be made under Rule 155, Tax Court Rules of Practice and Procedure.

Findings of Fact

Some of the facts were stipulated and they are so found. The stipulations of fact together with the exhibits attached thereto are incorporated herein by this reference.

Petitioner Esther C. Dickman (hereinafter Esther), an individual, resided in Ruskin, Florida, when her petition was filed herein. Gift tax returns were filed for each of the calendar quarters here involved; the returns for the first three calendar quarters of each year were filed with the Office of District Director, Jacksonville, Florida, and the returns for the fourth quarter of each year were filed with the Office of the Internal Revenue Service at Chamblee, Georgia.

Petitioner G. Wendell Smith, personal representative, is the duly qualified personal representative for the Estate of Paul B. Dickman, deceased. Gift tax returns were filed for each of the calendar quarters here involved; the returns for the first three calendar quarters of each year were filed with the Office of District Director, Jacksonville, Florida, and the returns for the fourth quarter of each year were filed with the Office of the Internal Revenue Service at Chamblee, Georgia.

Paul B. Dickman (hereinafter decedent) and Esther were husband and wife at all times relevant to this case and until decedent's death on December 22, 1976. Esther is now, and both decedent and Esther were, residents of Hillsborough County, Florida, at all relevant times.

Artesian Farms, Inc. (hereinafter Artesian) is a Florida corporation engaged (at all times relevant hereto) in farming and in operating a motel and restaurant. Artesian had two classes of stock outstanding. The only difference between the classes was voting rights. Ownership of Artesian stock was as follows:

	Total		Voting Common		Non-Voting Common	
	Shares	Percent	Shares	Percent	Shares	Percent
Paul B. Dickman *	370	9.02	170	20.74	200	6.08
Esther C. Dickman	100	2.44	98	11.96	2	.06
Lyle C. Dickman	678	16.54	236	28.78	442	13.48
Margaret R. Dickman	702	17.12	79	9.63	623	19.00
Paul R. Dickman	750	18.30	79	9.63	671	20.46
Edward L. Dickman	750	18.29	79	9.63	671	20.46
Glenn K. Dickman	750	18.29	79	9.63	671	20.46
TOTAL	4,100	100.00	820	100.00	3,280	100.00

*Includes non-voting stock held indirectly through 100 percent stock-ownership of a corporation which owned stock of Artesian.

Lyle C. Dickman (hereinafter Lyle) was the only child of decedent and Esther. Lyle died on May 13, 1976. Margaret R. Dickman was Lyle's wife and Paul R., Edward L., and Glenn K. Dickman are sons of Lyle and Margaret. All five of the men were active in the management of Artesian, although decedent was the dominant force in corporate affairs.

All of the stockholders of Artesian employed the cash basis, calendar year method of accounting; Artesian employed the accrual basis, June 30 fiscal-year method.

Decedent was a pioneer settler of Ruskin, Florida, and despite, very difficult times during the depression of the 1930's, made a fortune in agriculture and real estate. He was joined in business by his son, Lyle, following Lyle's discharge from the Armed Forces at the end of World War II. Lyle contributed greatly to the family businesses. When Lyle died on May 13, 1976, Lyle's gross estate for Federal estate tax purposes was $5,009,026.65. When decedent died on December 22, 1976, his gross estate for Federal estate tax purposes was $3,464,011.05.

During the calendar quarters here involved, decedent made interest-free loans to Lyle and to Artesian. The outstanding loan balances at the end of each calendar quarter for these loans were as follows:

Calendar Quarter Ending	Lyle	Artesian Farms, Inc.
March 31, 1971	$144,715.87	$374,650.00
June 30, 1971	144,715.87	374,650.00
September 30, 1971	144,715.87	300,578.00
December 31, 1971	144,715.87	300,578.00
March 31, 1972	144,715.87	669,733.00
June 30, 1972	144,715.87	669,733.00
September 30, 1972	144,715.87	669,733.00
December 31, 1972	144,715.87	669,733.00
March 31, 1973	225,615.87	457,641.00
June 30, 1973	225,615.87	457,641.00
September 30, 1973	225,615.87	457,641.00
December 31, 1973	225,615.87	457,641.00
March 31, 1974	225,615.87	356,806.00
June 30, 1974	225,615.87	356,806.00
September 30, 1974	225,615.87	420,515.00
December 31, 1974	225,615.87	420,515.00
March 31, 1975	277,915.87	420,515.00
June 30, 1975	277,915.87	420,515.00
September 30, 1975	342,915.87	471,454.00
December 31, 1975	342,915.87	471,454.00
March 31, 1976	342,915.87	471,454.00
June 30, 1976	342,915.87	471,454.00
September 30, 1976	342,915.87	207,875.00
December 31, 1976	342,915.87	207,875.00

Esther also made similar loans to Lyle and to Artesian. During the same period as reflected in the above table for loans by decedent, the outstanding balance at the end of each calendar quarter for loans by Esther to Lyle totaled $226,130.05, and for loans to Artesian totaled $68,651.02.

With two exceptions, all loans made by decedent and Esther to Lyle and Artesian were evidenced by non-interest bearing demand notes. One of the exceptions was a $65,000 loan by decedent to Lyle

on June 30, 1975. This loan was "open-account" and was payable on demand. The second exception was a $456,805.90 loan in 1972 from decedent to Artesian.

On March 16, 1969, First Federal Savings and Loan Association of Tampa (hereinafter First Federal) loaned $480,000 to Artesian, which loan was secured by a mortgage on a motel owned by Artesian. On January 31, 1972, decedent paid $456,805.90 to First Federal in complete satisfaction of this loan.

On March 28, 1972, Artesian issued a note and mortgage to decedent for $456,805.90. Such note (hereinafter term note) and mortgage provided for no interest and for payment on or before March 28, 1982. No explanation was provided concerning the 2-month delay in issuing the term note and mortgage. The mortgage was not recorded. Partial repayment of the $456,805.90 amount was made by Artesian to decedent during the period involved.[2]

Artesian's books contain the following entries with regard to the foregoing transaction:

Date	Account	Amount
Jan. 31, 1972	Mortgage Payable—First Federal	$456,805.90 (Debit)
Jan. 31, 1972	Paul B. Dickman—Personal	456,805.90 (Credit)
Jan. 29, 1973	Paul B. Dickman—Personal	456,805.90 (Debit)
Jan. 29, 1973	Mortgage Payable—Paul B. Dickman, Personal	456,805.90 (Credit)

No explanation was provided concerning why the amount was transferred to a different account in January 1973.

The only relevant entry on decedent's personal books was a $456,805.90 debit to an "Artesian Farms Mtg." account on December 31, 1972.

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2 A specific record of repayments by Artesian to decedent was not provided. As shown by the table detailing the outstanding loan balances at the end of each calendar quarter, it is evident that some repayments were made. On brief petitioners state that, as funds became available and repayments made, the bookkeeping accounts pertaining to the demand loans were debited first and the account pertaining to the term note was debited last.

In the statutory notices of deficiency, respondent determined that the loans made by decedent and Esther to Lyle and Artesian resulted in taxable gifts to the extent of the value of the use of the amounts loaned. In determing the amount of the gifts, respondent applied the following interest rates to the loan balanaces outstanding at the end of each taxable quarter:

Taxable Quarters Ending Within:	Interest Rate
Jan. 1, 1971 - June 30, 1975	6 percent
July 1, 1975 - Jan. 31, 1976	9 percent
Feb. 1, 1976 - Dec. 31, 1976	7 percent

The interest rates used were the same as those established under section 6621, I.R.C. 1954, as made applicable by section 6601 to underpayments in tax.

In determining the gift tax deficiencies for the calendar quarters involved, it was necessary to determine the base or total net or taxable gifts for calendar years prior to the period at issue herein. In determining these base amounts, respondent included therein as gifts an amount for interest on non-interest demand loans made by decedent and Esther to Lyle during the calendar years prior to the period at issue.

When the statutory notices of deficiency were issued, respondent was unaware of the existence of the March 1972 term note. By amended answer respondent asserts a greater deficiency for calendar quarters ending on March 31, 1972, based on the assertion that decedent received the term note in exchange for his payment of the $456,809.90 amount to First Federal and that a gift resulted to the extent the fair market value of the term note was exceeded by the $456,809.90 amount.[3] The fair market value of the term note was computed to be $255,078.13 [$456,809.90 (face amount) × 0.558395 (the remainder interest in 10 years computed at a discount rate of 6 percent under section 25.2512-9(f), Table B, Gift Tax Regs.)] and, thus, the taxable gift to be $201,727.77 ($456,809.90 — $255,078.13).

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3 In the case of Esther, the increased deficiency would result from the application of the split gift provisions. Respondent originally determined the gift tax deficiencies herein by treating the $456,809.90 amount as part of the loan balances outstanding at the end of the calendar quarters.

Opinion

The principal issue for decision is whether any of the loans made by decedent and Esther to their son and to a closely-held corporation resulted in taxable gifts.[4]

Recently, in *Crown v. Commissioner* [Dec. 34,331], 67 T. C. 1060 (1977), aff'd. [78-2 USTC ¶ 13,260] 585 F.2d 234 (7th Cir. 1978), the Court had before it the question whether intra-family, interest-free demand loans gave rise to taxable gifts to the extent of the value of the use of the loan proceeds. In *Crown* it was held that such loans did not result in taxable gifts. Respondent does not argue that the instant loans evidenced by demand notes are factually distinguishable from those in *Crown* or that *Crown* is otherwise distinguishable, rather he only argues that *Crown* was incorrectly decided.

As he did in *Crown* and in Rev. Rul. 73-61, 1973-1 C.B. 408, respondent contends herein that the loan-recipient's right to use the loan proceeds was a valuable property interest and that the receipt of such a property interest without full and adequate consideration being given in exchange therefor (in the form of an obligation to make interest payments) resulted in taxable gifts. In addition, respondent argues that the broad scope of the gift tax provisions requires that interest-free demand loans be subject to gift tax.

Respondent has not advanced any argument that was not earlier considered and discussed either by this Court in its opinion in *Crown* or the Seventh Circuit in its opinion affirming this Court in *Crown*. The only other case directly in point on this issue is *Johnson v. United States* [66-1 USTC ¶ 12,386], 254 F. Supp. 73 (N. D. Tex. 1966), which reached the same conclusion on this issue that we reached in *Crown*. While, as evidenced by the dissents from both this Court's and the Seventh Circuit's *Crown* opinions, the answer to the question presented is not above dispute, we see no purpose in reconsidering our decision in *Crown* at this time.[5] Accordingly, we conclude that the demand and open-account loans made by decedent and Esther did not result in taxable gifts.

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4 Respondent makes no argument that any loan was not in fact bona fide. The parties agree that the gift tax consequences of the "open-account" loan is the same as that of the loans evidenced by the demand notes.

Notwithstanding *Crown*, respondent argues that a different result attaches to the $456,809.90 loan by decedent to Artesian, which loan is evidenced by the term note. Respondent contends that a non-arm's-length, unequal exchange occurred herein when decedent received the 10-year term note, the fair market value of which respoondent calculated to be $255,078.13, in exchange for the $456,809.90 loan, thus resulting in a taxable gift of $201,727.77.

Although there is scant evidence as to why a term note was executed in connection with the $456,809.90 loan,[6] we find it difficult to conclude that there was in fact an "exchange" of the term note for the loan of that this loan was substantially different than the other loans made by decedent to Artesian. Decedent was the dominant force in corporate affairs and he made a practice of making interest-free loans to the corporation. From all accounts, it appears that decedent viewed his financial affairs and those of Artesian as one, such that these interest-free loans were made when, from the standpoint of the most productive use of the funds, it was in the best interests of himself and the corporation. As the history of partial loan repayments indicates, decedent's loans to Artesian would be repaid when it was financially beneficial to do so. It was at such times that "demand" for repayment would be made. Given these circumstances, it is difficult to ascribe much significance to the term note provision requiring repayment of the principal within 10

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5 We do not overlook the fact that both Courts in *Crown* mentioned the fact that respondent had not raised this issue in this context until *Johnson v. United States* [66-1 USTC ¶ 12,386], 254 F. Supp. 73 (N. D. Tex. 1966), which was not appealed, and did not announce an official position on the issue until Rev. Rul. 73-61, 1973-1 C. B. 408, which was after the transfers occurred in *Crown*, and that in this case some of the transfers occurred prior to and some after Rev. Rul. 73-61. However, neither Court relied on the retroactive-prospective point in reaching their conclusions and we do not believe it should make any difference in this case. The legal arguments espoused in those opinions, as opposed to the equitable argument, supported the opinions in *Crown* and also support the conclusion we reach on this issue here.

6 The absence of such evidence is principally due to the death prior to trial of both decedent and Lyle. Considering that the term loan pre-dated both *Crown v. Commissioner* [Dec. 34,331], 67 T. C. 1060, (1977), aff'd [78-2 USTC ¶ 13,260] 585 F. 2d 234 (7th Cir. 1978), and Rev. Rul 73-61, 1973-1 C. B. 408, there was little gift-tax reason for giving much thought to the manner in which the loan was evidenced.

years. We believe this loan was in effect no different than those in *Crown*. If *Crown* stands for the proposition that bona-fide, interest-free demand loans made in an intra-family setting do not give rise to taxable gifts, under the facts of this case we see no reason to distinguish the $456,809.90 loan from the other loans when it is clear that repayment of the $456,809.90 loan would occur under the same circumstances as the other loans. While this conclusion may highlight the fiction of the "demand" element of *Crown*-type loans, it does not undercut the rationale of *Crown* that Congress must act if these types of loans are to become taxable events.

Accordingly, we conclude that the $456,809.90 loan was in substance a demand loan, as a result of which there is no gift tax consequence. *Crown v. Commissioner, supra; Johnson v. United States, supra.*[7]

Decisions will be entered for the petitioners.

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7 Having reached this conclusion, it is unnecessary to address the question whether interest-free term loans have different gift tax consequences than interest-free demand loans. See *Estate of Berkman v. Commissioner* [Dec. 35,866(M)], T. C. Memo. 1979-46, which however, is distinguishable from this case. See also *Blackburn v. Commissioner* [Dec. 19,621], 20 T. C. 204 (1953).

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No. 82-1041

In the Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND ESTATE OF PAUL B. DICKMAN, DECEASED, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The question presented in this federal gift tax case is whether Paul and Esther Dickman's interest-free loans to their son and to a family-owned corporation constitute taxable gifts in the amount of the value of the loans measured by statutory rates of interest.

The pertinent facts are undisputed and may be summarized as follows: Paul and Esther Dickman were husband and wife until Paul's death in December 1976 (Pet. App. 2a, 17a). Over a period of years, they made interest-free loans totalling hundreds of thousands of dollars to their child, Lyle C. Dickman, and to a family-owned corporation, Artesian Farms, Inc. ("Artesian") (*id.* at 2a, 18a-19a).[1] The outstanding balances of the loans at the end of each

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[1]Lyle died on May 13, 1976 (Pet. App. 18a). Artesian's stock ownership is set out in the court of appeals' opinion (*id.* at 2a n.1).

calendar quarter of 1971 through 1976 are set forth in the court of appeals' opinion (Pet. App. 2a n.2). With two exceptions, all loans were evidenced by noninterest bearing demand notes. One exception was a loan made to Lyle on "open-account" and payable on demand. The other was a loan in the amount of $456,805.90 made to Artesian in March 1972, and evidenced by a ten-year term note (*id.* at 2a-3a, 19a-20a).

On audit, the Commissioner of Internal Revenue concluded that the loans resulted in taxable gifts to the extent of the value of the loans. Accordingly, he determined deficiencies in gift tax for all calendar quarters in the years 1971 through 1976, totalling $83,332.69 (Pet. App. 3a-4a, 21a).[2] In this proceeding brought by petitioners to contest the Commissioner's determination, the Tax Court followed its prior decision in *Crown* v. *Commissioner*, 67 T.C. 1060 (1977) (reviewed by the court), nonacq., 1978-2 Cum. Bull. 3, aff'd, 585 F.2d 234 (7th Cir. 1978), where it had held that intra-family, interest-free loans, payable on demand, did not result in taxable gifts. Accordingly, the court held that the instant loans did not result in taxable gifts (Pet. App. 15a-24a).[3]

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[2]The Commissioner determined the amount of the gifts by multiplying the loan balance outstanding at the end of each taxable quarter by interest rates ranging between 6% and 9%, which were the rates applicable under 26 U.S.C. (& Supp. V) 6601 and 6621 to tax underpayments (Pet. App. 3a n.4, 21a).

[3]In the notices of deficiency, the Commissioner treated all the loans as if they were payable on demand, each resulting in a continuing gift for the period during which the loan was left outstanding. By amended answer, however, the Commissioner contended that the $456,805.90 loan was a 10-year term loan and resulted in a gift in the calendar quarter in which the loan was made, equal to the difference between the amount lent and the fair market value of the term note given by Artesian (Pet. App. 21a). The Tax Court, however, rejected this argument, finding that the loan in question in fact was a demand loan (*id.* at 23a-24a). See further page 3 note 5, *infra*.

The court of appeals reversed (Pet. App. 1a-14a).[4] Disagreeing with the Seventh Circuit's *Crown* decision, the court held that "interest-free loans are subject to the gift tax whether the loans are made for a fixed term or are on a demand basis" (*id.* at 1a). The court found this conclusion "compelled by the gift tax statute as it is illuminated by its legislative history, established treasury regulations, judicial interpretation, and the policy considerations underlying it" (*id.* at 13a).[5]

DISCUSSION

1. The decision below correctly held that Paul and Esther Dickman made taxable gifts by making interest-free loans to their son and to a family-owned corporation.[6]

The gift tax is intended to reach every transfer for less than full and adequate consideration of any type of property, right to property, or interest in property having value. Section 2501(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. & Supp. V) (App., *infra*, 1a) imposes a gift tax on "the transfer of property by gift" by an individual. Section 2511(a) (App., *infra*, 1a) provides that "the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." See

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[4]The opinion of the court of appeals is reported at 690 F.2d 812 (1982).

[5]The court of appeals remanded the case to the Tax Court to determine the amount of the taxable gifts (Pet. App. 1a). The court declined to decide whether the Tax Court had correctly found that the $456,805.90 loan was a demand loan, stating that the characterization of that loan relates to the valuation issue, and "it is not absolutely clear at this point what difference the characterization will make since we hold that both term and demand loans produce taxable consequences" (*id.* at 3a n.3).

[6]The income tax consequences arising from nonarms'-length loan transactions are not at issue here (see Pet. App. 12a-13a n.8).

also Section 2512(b). The gift tax does not turn on a showing of donative intent. Rather, any transfer not in the ordinary course of business that is for less than full and adequate consideration is a taxable gift. *Commissioner* v. *Wemyss*, 324 U.S. 303, 306-307 (1945).

The committee reports accompanying the Revenue Act of 1932, ch. 209, Sections 501-507, 47 Stat. 245-249, which enacted the present federal gift tax, reflect Congress' specific intention to reach any gratuitous transfer of any interest in property:

> The terms "property," "transfer," "gift," and "indirectly" are used in the broadest and most comprehensive sense; the term "property" reaching every species of right or interest protected by law and having an exchangeable value.
>
> The words "transfer * * * by gift" and "whether * * * direct or indirect" are designed to cover and comprehend all transactions (subject to certain express conditions and limitations) whereby, and to the extent * * * that, property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment.

H.R. Rep. No. 708, 72d Cong., 1st Sess., 27-28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).

The Treasury Regulations likewise embody the same broad definition of a taxable gift. They state:

> Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

Treasury Regulations on Gift Tax (26 C.F.R.), Section 25.2511-1(c).

This Court has reaffirmed on several occasions that the gift tax provisions should be broadly applied to effectuate the clear, sweeping intent of Congress. In *Commissioner* v. *Wemyss, supra*, 324 U.S. at 306, the Court stated that, "Congress intended to use the term 'gifts' in its broadest and most comprehensive sense," and acknowledged "the evident desire of Congress to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech." In *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943) (emphasis added), the Court stated that "[t]he language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, *however conceptual or contingent.*" See also *Robinette* v. *Helvering*, 318 U.S. 184, 187 (1943) (the purpose of the gift tax was to "reach every kind and type of transfer by gift").

Here, Paul and Esther Dickman gave their son, Lyle, and their family (through their corporation Artesian)[7] the right to use hundreds of thousands of dollars for extended periods of time. Clearly, these were transactions, in the language of Section 25.2511-1(c) of the Regulations, "whereby property or property rights or interests [were] gratuitously passed or conferred upon another" and consequently were subject to the gift tax. It is fundamental that the *right* to use property for a pre-determined definite period of time is itself "property," whether that underlying property is real estate, money[8] or other property. *Threlfall* v. *United States*, 302 F. Supp. 1114, 1118-1119 (W.D. Wis. 1969) (term leasehold is property); *Allen* v. *Commissioner*, 57

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[7]A gratuitous transfer to a corporation is treated as a gift to the shareholders in proportion to their ownership interests in the corporation. Treasury Regulations on Gift Tax (26 C.F.R.), Section 25.2511-1(h)(1).

[8]For these purposes, money is "property." See H.R. Rep. No. 708, *supra*, at 30.

T.C. 12 (1971) (same). This is also true where the right to use property is not for a definite predetermined period, but is to last for some indefinite period.[9] It is equally clear that the right to use property for an indefinite period, terminable at any time by the property's owner, also is "property."[10]

The transfers of the legal rights to use, interest-free, hundreds of thousands of dollars in this case were therefore transfers of "property," whether these rights were to last for a predetermined period or were terminable at any time by the lenders. Further, it is conceded that those transfers were made without consideration. Under the plain terms of the statute, those transfers constituted taxable gifts.[11] See *Blackburn* v. *Commissioner*, 20 T.C. 204 (1953) (transfer of property for term note bearing below-market interest was taxable gift); *Estate of Berkman* v. *Commissioner*, 38

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[9]See Treasury Regulations on Gift Tax, Section 25.2512-5(c) (right to use property for the life of another person is property); *Abbott* v. *United States*, 74-2 U.S.Tax Cas. (CCH) para. 13,040 (S.D. Miss. 1974) (same); *Sullivan* v. *Commissioner*, 16 T.C. 228, 231 (1951), acq., 1951-1 Cum. Bull. 3 (right to use property for duration of war is property); *Thriftimart, Inc.* v. *Commissioner*, 59 T.C. 598, 615-616 (1973), acq., 1973-2 Cum. Bull. 4, remanded on other issues (9th Cir. Dec. 10, 1975) (lease which is terminable by owner on sale of building is property).

[10]See, e.g., *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1963) (the right to use real estate for such time as the owner permitted was property); Rev. Rul. 73-61, 1973-1 Cum. Bull. 408. See also *Threlfall* v. *United States, supra*; *Allen* v. *Commissioner, supra*, 57 T.C. at 14.

[11]Contrary to petitioners' statement (Pet. 3), the court of appeals here did not "impute" interest, any more than taxing a gift of stock "imputes" sales proceeds. The court simply held that since Paul and Esther Dickman transferred "property," i.e., the right to use money, for less than full and adequate consideration, they made taxable gifts. The only relevance of interest would be in determining the amounts of the gifts. The arms-length interest rate a borrower would have to pay to obtain a similar loan should measure the value of the gift, just as an arms'-length sales price would measure the value of, for example, a gift of stock.

T.C.M. (CCH) 183 (1979) (term loan bearing below-market interest was taxable gift); Rev. Rul. 73-61, 1973-1 Cum. Bull. 408. Cf. *Mason* v. *United States*, 513 F.2d 25 (7th Cir. 1975). See also Treasury Regulations on Gift Tax, Section 25.2511-2(f), which provides that, in the case of a transfer of property which is an incomplete gift because the donor retains dominion and control, any "enjoyment of the transferred property by the transferee" during the period before the gift is complete "constitutes a gift of such * * * [beneficial] enjoyment taxable as of the calendar quarter * * * of its receipt."[12]

Moreover, the decision below furthers two basic purposes of the gift tax. That tax, in addition to being an independent tax in its own right, was designed to supplement and protect both the estate tax and the income tax by taxing inter-vivos gifts and thereby preventing taxpayers from reducing their yearly incomes as well as their gross estates through tax-free gifts to close family members and others. *Smith* v. *Shaughnessy, supra*, 318 U.S. at 179 n.1; *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 45 (1939).

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[12]The conclusion that interest-free loans, whether term or demand, result in taxable gifts has received strong support from the commentators, who have sharply criticized the holdings of both the Tax Court and the court of appeals in *Crown*. See, e.g., S. Surrey, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation: Cases and Materials* 154-156 (2d ed. 1982); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* para. 10.01[2][f], at 10-10 & S10-1 to S10-2 (4th ed. 1978 & Cum. Supp. No. 2, 1982); H. Dubroff & D. Kahn, *Federal Taxation of Estates, Gifts, and Trusts* para. 20.02, at 314 (3d ed. 1980); Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459, 468-469, 489-490 (1980); Pulliam, *Income and Gift Tax Implications of Nonbusiness Interest-Free Loans: Looking a Gift Horse in the Mouth*, 58 Taxes 675 (1980); Carey, *Interest-Free Loans and the Gift Tax: Crown* v. *Commissioner*, 38 Ohio St. L.J. 903, 907-916 (1977). See also O'Hare, *The Taxation of Interest-Free Loans*, 27 Vand. L. Rev. 1085, 1088 (1974).

See H.R. Rep. No. 708, *supra*, at 28; S. Rep. No. 665, *supra*, at 40. Here, Paul and Esther Dickman succeeded in shifting to Lyle and Artesian the income that would be generated by the money lent them, thereby reducing their income taxes, and ultimately the amounts of their taxable estates. Indeed, as the Seventh Circuit in *Crown* acknowledged with respect to this income-splitting device (585 F.2d at 236) (emphasis added; footnote omitted):

> The concern here is that people will use gifts of income producing property to split up an income taxable in a high tax bracket into smaller incomes taxable in lower brackets. *No-interest loans do just that.* Moreover, where the loans are payable on demand, the maker of the loans is able to achieve this result without the inconvenience of losing access to the principal should the need arise.

2. We do, however, agree with petitioners (Pet. 3) that the decision below squarely conflicts with that of the Seventh Circuit in *Crown* v. *Commissioner, supra.*[13] There, a family-owned partnership made interest-free demand loans totalling more than $18 million to a series of trusts established for the children and other close relatives of the partners. The Seventh Circuit, with one judge dissenting, held that the loans had no gift tax consequences.[14] The court in *Crown* acknowledged the "broad sweep of the gift tax statutes," but concluded that demand loans did not come within the statutory definition of a taxable gift (585

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[13]The decision also conflicts with that of the district court in *Johnson* v. *United States*, 254 F. Supp. 73 (N.D. Tex. 1966).

[14]The Seventh Circuit intimated, however, that an interest-free *term* loan might result in a taxable gift (see 585 F.2d at 237 & n.7). But as the court here correctly held, interest-free loans result in gifts whether made on a term or demand basis (Pet. App. 1a). The only difference will be in the method of valuation and timing of the gift. See page 3 note 5, *supra*.

F.2d at 238-240). The court's fundamental error, we submit, was its failure to recognize two principles: First, that the right to use property is itself "property" within the meaning of the statute. Second, as the court below analyzed the transaction (see Pet. App. 11a), an interest-free demand loan is an ongoing gift of property for as long as the lender permits the borrower to retain the money, and that consequently the amount of the gift depends on the period the loan is left outstanding.

Tax practitioners and financial advisers have widely recognized and advocated the use of interest-free loans as a tax-free device to split incomes and reduce estate taxes.[15] Indeed, in *Crown* the taxpayers successfully transferred, tax free, property worth more than $1 million to their children and other close relatives. See 67 T.C. at 1065.

The issue is one of substantial and continuing importance in the administration of the tax laws. We are advised by the Internal Revenue Service that there may be as many as 31 pending cases, either in litigation or at the administrative level, in which this issue is raised, and that these cases may

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[15]See, e.g., Bettner, *Interest-Free Loan to Poorer Relation Can Cut Income Taxes if He Invests Money in His Name*, Wall St. J., Dec. 20, 1982, at 42, col. 1; Thater & Richey, *An Overview of Cases Dealing with Interest-Free Loans*, 121 Trusts & Estates, No. 12, at 35 (Dec. 1982); Mitchell, *Interest-Free Loans: Opportunities for Tax Planning*, 65 A.B.A.J. 634, 636 (1979); Edwards, *What Planning Opportunities Does CA-7's No-Gift Tax Holding in Crown Open Up?*, 50 J. Tax. 168, 170 (1979); Aslanides & McGowan, III, *Interest-Free Loans Get Green Light as Compensation and Estate Planning Devices*, 21 Tax. Acct. 260, 264-265 (1978); Taicher, *How to Use Interest-Free Loans in Family Tax Planning*, 11 Prac. Acct. 24, 27-28 (Sept. 1978); Tidwell, *Lester Crown Points the Way to Estate Tax Reduction Under the 1976 Tax Reform Act*, 55 Taxes 651 (1977); Burke, Jr., *Interest-Free Loans — A Valuable Family Tax Planning Tool?*, 48 Taxes 137 (1970); Seidman & Stuetzer, Jr., *Tax Clinic*, 120 J. Acct. 75 (Dec. 1965).

involve as much as $5.5 million in tax.[16] Accordingly, we do not oppose the granting of the petition for a writ of certiorari.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

REX E. LEE
Solicitor General

JANUARY 1983

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[16]The actual revenue impact of the interest-free loan gift tax issue may well be far greater than even these figures indicate. Intra-family loans are necessarily difficult to uncover on audit. In addition, although interest-free loans worth in excess of the $10,000 per donee annual exclusion (26 U.S.C. (& Supp. V) 2503(b)) would deplete the taxpayer's available unified credit against gift tax (26 U.S.C. (& Supp. V) 2505), currently equivalent to an "exemption" from the gift tax for $275,000 in gifts, there would be no gift or estate tax consequences until that credit was exhausted. See further Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 Colum. L. Rev. 161, 186 (1977).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

Section 2501. Imposition of tax

[as amended by Section 109(a), Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539, and Section 102(a)(1), Excise, Estate, and Gift Tax Adjustment Act of 1970, Pub. L. No. 91-614, 84 Stat. 1838.]

(a) *Taxable Transfers*

"(1) *General rule.*—For the first calendar quarter of calendar year 1971 and each calendar quarter thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident."

* * * * *

Section 2511. Transfers in general

(a) Scope

Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.

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No. 82-1041

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND
ESTATE OF PAUL B. DICKMAN, DECEASED,
G. WENDELL SMITH, PERSONAL REPRESENTATIVE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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QUESTION PRESENTED

Is a failure to demand repayment of an interest-free demand loan a "transfer of property by gift" subject to the federal gift tax?

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No. 82-1041

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND
ESTATE OF PAUL B. DICKMAN, DECEASED,
G. WENDELL SMITH, PERSONAL REPRESENTATIVE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit (Pet. A.* 1a-14a) is reported at 690 F.2d 812 (1982). The opinion of the United States Tax Court is unofficially reported at 41 T.C.M. (CCH) 620 (1980) (Pet. A. 15a-24a).

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on November 1, 1982. The Petition for Writ of Certiorari was granted by this Court on February 22, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1983).

*Pet. A. refers herein to the Appendix to the Petition for Writ of Certiorari.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Internal Revenue Code of 1954, as amended (26 U.S.C.):

I.R.C. § 2501(a)(1) imposes a gift tax:

> "on the transfer of property by gift. . . ."

I.R.C. § 2511(a) provides in part:

> "[T]he [gift] tax . . . shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . ."

I.R.C. § 2512(a) provides:

> "If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift."

Treasury Regulations (26 C.F.R.):

Treas. Reg. § 25.2511-1(c) provides in part:

> "Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax."

Treas. Reg. § 25.2511-2(a) provides in part:

> "The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. . . . On the contrary, the tax is . . . an excise

upon [the donor's] act of making the transfer [and] is measured by the value of the property passing from the donor . . ."

Treas. Reg. § 25.2512-1 provides in part:

"The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts."

STATEMENT OF THE CASE

Petitioner Esther C. Dickman (hereinafter "Esther") is an individual residing in Hillsborough County, Florida. Petitioner G. Wendell Smith, Personal Representative, is the duly qualified personal representative for the Estate of Esther's deceased husband, Paul B. Dickman (hereinafter "Paul"), who died on December 22, 1976 (Pet. A. 17a). Paul and Esther were early settlers in the small town of Ruskin, Florida, who, despite difficult times in the 1930's, achieved success in agricultural and real estate business pursuits (Pet. A. 18a).

Artesian Farms, Inc. (hereinafter "Artesian") is a Florida corporation engaged in farming and in operating a motel and restaurant. Artesian was owned at all times relevant hereto by Paul, Esther, their son, Lyle, and Lyle's wife and three children (Pet. A. 17a-18a).

During the calendar years 1971 through 1976, Paul and Esther had several demand loans outstanding (hereinafter the "Loans") to Lyle and to Artesian. All of the Loans were payable upon the demand of the lender and were interest-free. With two exceptions, all of the Loans were evidenced by properly executed

promissory notes containing such terms.[1] Several partial repayments of the Loans were made during the years at issue, but significant amounts remained outstanding at Paul's death in 1976, which occurred approximately six months after the death of his son, Lyle (Pet. A. 18a-20a). There is no question that the Loans were in fact bona fide.[2] The full amount of the outstanding Loans made by Paul was included as a part of his taxable estate.

Respondent Commissioner of Internal Revenue (hereinafter "IRS") determined deficiencies in Paul and Esther's federal gift taxes for all calendar quarters in the years 1971 through 1976 (Pet. A. 21a). The deficiencies asserted in these six years were in the aggregate sum of $83,322.69 (Pet. A. 15a-16a).[3] These claimed deficiencies were based on a determination by the IRS that the failure to demand repayment of the Loans constituted taxable gifts during each calendar quarter to the extent of the "value of the use" of the amounts loaned (Pet. A. 21a). In determining the amount of the alleged "gift," the IRS did not make any factual determination as to the market value of such use or as to the use, if any, to which the sums loaned would have been put by Paul and Esther. Instead, the IRS simply applied the interest rates established under I.R.C. § 6621 — rates applicable for determining interest due on underpayments or refunds of tax — to the loan balances outstanding at the end of each taxable quarter, and denominated the result as the amount of "gifts" by Paul and Esther (Pet. A. 21a).

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[1] One exception was an open-account loan payable on demand (Pet. A. 19a-20a). The second exception was a loan which in form was a term loan but which the Tax Court found as a fact to be in substance a demand loan (Pet. A. 20a, 23a-24a).

[2] The Tax Court stated: "Respondent [IRS] makes no argument that any loan was not in fact bona fide" (Pet. A. 22a n.4). There is no suggestion in the record that the Loans were not in good faith intended by all parties to be repaid, or that there was any agreement, implicit or otherwise, that payment of the loans would not be demanded for any period of time. Nor is there any suggestion that the loans were motivated by any effort to avoid taxes in any respect, or that the borrowers were insolvent or otherwise incapable of repaying them at any time.

[3] The parties since have determined that the calculation of deficiencies should be revised in certain respects not at issue herein (Pet. A. 16a n.1).

SUMMARY OF THE ARGUMENT

The gift tax is imposed upon the "transfer of property by gift." Congress never intended these words to be read to include the making of a valid interest-free demand loan, or the failure to demand repayment of such loan at a particular time.

Interest-free loans of money or other property within families are a common and important part of American life, and have been since long before enactment of the present gift tax law by Congress in 1932. For example, a woman lends her sister money to pay large medical bills occasioned by a serious operation, with no thought that interest should be required nor that a gift is being made. Further, the legislative history of the gift tax law makes no reference to loans as potential vehicles for "gifts." The IRS, for at least thirty years after enactment of the gift tax law, did not claim that a valid interest-free demand loan could give rise to a taxable gift.

Since the IRS first contended in the mid-1960's that an interest-free demand loan could result in a taxable gift, its position had been squarely rejected by every court that considered it until the decision of the Court of Appeals below. Despite these adverse court decisions, the IRS neither sought nor obtained Congressional alteration of the gift tax law on this issue. Congress amended the gift tax law in 1966, 1969, 1970, 1974, 1976, 1978 and 1981 without any suggestion of disagreement with the decided case law.

Analysis of the language of the gift tax statute in accordance with its ordinary meaning also leads to the same result — neither the making of a valid interest-free demand loan, nor the failure to demand repayment of it at a particular time, result in a

"transfer of property by gift." The IRS has recognized that no taxable "transfer" occurs at the time of the loan — the only time at which a "transfer" could be said to occur. Further, a failure to demand repayment over a period of time cannot fairly be characterized as a continuous series of minute "transfers of property" during that period. The contention of the IRS in this case rests not on the language of the gift tax law, but upon a theory which would tax every failure to act which creates a potential economic benefit to others. Congress plainly did not intend to cast the net of gift taxation so far beyond the words of the statute. A taxable "transfer of property" cannot be equated with a non-taxable "opportunity for economic benefit."

Moreover, any adoption of such a theory by this Court would generate wide-ranging practical problems. The value of a failure to obtain maximum compensation for another's use of one's property would have to be determined on the basis of the facts and circumstances of each case, not by application of an arbitrary interest rate such as the rate put forth by the IRS in this case. Valuation trials requiring testimony on a borrower's creditworthiness and various market rates of interest, all for multiple years, would further burden already crowded court dockets. Taxpayers would be required to keep records of multitudinous intra-family "transfers" of benefits and opportunities and government and taxpayer alike would be placed in the difficult position of having to determine the gift tax value of such "transfers" both administratively and judicially. Imposition of a rule which would create such vagarious results would be illogical, and retroactive imposition would be manifestly unfair.

Further, adoption of a broad rule that interest-free demand loans give rise to taxable gifts would produce obviously unintended anomalies. An outright gift of money to charity would not be a taxable gift but would give rise to an income tax

deduction, while an interest-free loan to that charity would be a taxable gift but no income tax deduction would be allowed. Outright payment of another's college tuition or medical expenses would be exempt from gift tax, while an interest-free loan made for such purposes would result in a taxable gift. The gift tax on an interest-free loan could be greater than the gift tax on an outright gift of the same sum.

The imposition of a tax on interest-free demand loans is clearly a matter best suited for legislative rather than judicial determination. Not only does this issue involve far-reaching matters of tax policy, but it also requires a comprehensive and workable system for taxation of such loans — if any taxation is appropriate. Only Congress is in a position to develop such a system. The need to avoid imposing such a tax retroactively on unsuspecting taxpayers, the desirability of public participation in the framing of applicable rules, and the need to minimize otherwise serious administrative and reporting problems by adopting "safe-harbor" rates and appropriate exceptions, all argue for a Congressional resolution of the issues before this Court.

For all of these reasons, this Court should reverse the decision of the Court of Appeals, and the IRS should direct any economic or tax policy arguments for taxation of loans such as the loans made by the Dickmans to the body whose constitutional role it is to enact the tax laws.

ARGUMENT

I. Neither the Making of Interest-Free Demand Loans Nor the Failure to Demand Repayment of Such Loans Constitutes a Taxable "Transfer of Property by Gift."

In 1932 Congress enacted the modern gift tax law, imposing a tax upon "the transfer of property by gift." I.R.C. § 2501. In order to achieve its primary objective of preventing evasion of the estate tax by *inter vivos* gifts,[4] Congress used broad language so as to subject all such transfers to taxation, whether the property be tangible or intangible and whether the gift be effected directly or indirectly. I.R.C. § 2503. Since enactment of the law, however, Congress has never expanded the essential scope of the tax in any respect, or altered the definition of the controlling statutory terms. Unless there is a "transfer of property by gift" within the intention of Congress, a transaction is not subject to gift taxation under our law.

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[4]Congress' primary objective in enacting the gift tax in 1932 was to supplement the estate tax. "In short, the design is to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death. The tax will reach gifts not reached, for one reason or another, by the estate tax." S. REP. No. 665, 72nd Cong., 1st Sess. 40 (1932), *reprinted in* 1939-1 C.B. (Part 2) 496, 525; H. REP. No. 708, 72nd Cong., 1st Sess. 28 (1932), *reprinted in* 1939-1 C.B. (Part 2) 457, 477. Congress' objective has been recognized by this Court. *E.g., Harris v. Commissioner, 340 U.S. 106, 107 (1950); Sanford's Estate v. Commissioner,* 308 U.S. 39, 44 (1939).

Similarly, the predecessor to the 1932 gift tax statute was enacted in 1924 as a "corollary" or as "supplemental" to the estate tax. 65 Cong. Rec. 8095-96 (daily ed., May 8, 1924) (remarks of Rep. Green). Prior to 1926, the estate tax included a presumption that gifts made within two years of death were made in contemplation of death and were therefore subject to the estate tax. Congress established this presumption as irrebuttable in the Revenue Act of 1926. Revenue Act of 1926, ch. 27, § 302(c), 44 Stat. 9 (1926). At that time Congress also repealed the 1924 gift tax statute. *Id.*, § 1200(a). A gift tax was reinstituted in 1932 following the Supreme Court's decision in *Heiner v. Donnan,* 285 U.S. 312 (1932), that the presumption violated the Fifth Amendment of the United States Constitution. Revenue Act of 1932, ch. 209, §§ 501-531, 47 Stat. 169 (1932). Without such presumption, the gift tax again was necessary to prevent avoidance of the estate tax through the use of *inter vivos* gifts.

The decision of the Court of Appeals below represents the first and only occasion in the fifty-one year history of the gift tax law in which any court has held that failure to demand repayment of a bona fide interest-free demand loan constitutes a taxable "transfer of property by gift." In so holding, the Court of Appeals embraced a position of the IRS which was first asserted over thirty years after enactment of the law, and which has been squarely rejected by three courts. This position — simply stated — is that the mere opportunity to use property, even for a moment and subject to withdrawal at any time, is itself a "transfer of property by gift" which Congress intended to tax. Because the decision of the Court of Appeals would apply the gift tax in circumstances which are far beyond both the letter and purpose of the statute, it should be reversed and the decision of the Tax Court should be affirmed in all respects.

A. The History of Congressional and Administrative Action Indicates that No Gift Tax Upon Interest-Free Demand Loans was Intended.

In 1932, as today, interest-free demand loans within families were common features of American life, made for reasons wholly apart from tax considerations.[5] Indeed, the members of Congress in that year likely would have deemed most unusual any instance in which a father insisted upon interest from his adult daughter on money which he loaned her to pay for her medical expenses, or in which a farmer charged his adult son for the temporary use of farm animals or equipment or for a loan to buy seed for the planting of crops. Is there reason to believe that the same Congress nevertheless intended to cause such loans to result in taxable "transfers of property by gift" in the absence of such charges?

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[5] Interest-free loans among non-family members have also long been a means for providing assistance to those in need. The Hebrew Free Loan Society has been making interest-free loans to immigrants in New York City since 1892. These loans are used to enable an immigrant to make a start, to help tide over a family or an elderly person in a crisis situation, or otherwise to assist individuals. Since its inception in 1892, the Society has loaned without interest over $82 million, virtually all of which has been repaid. N.Y. Times, May 1, 1983, §1, at 60, col. 3.

No evidence of such an intention can be found in any of the legislative history of the gift tax law. *See Crown v. Commissioner*, 585 F.2d 234, 237-39 (7th Cir. 1978). There is no suggestion by Congress that a bona fide loan might somehow be recharacterized as a "gift of the use of property" and subjected to taxation. To the contrary, it must be concluded that Congress used the terms "transfer of property by gift" in the literal, non-technical and ordinary sense in which they were used at that time. *See, e.g., Hanover Bank v. Commissioner*, 369 U.S. 672, 687-88 (1962); *Quinlivan v. Commissioner*, 599 F.2d 269, 271 (8th Cir. 1979), *cert. denied*, 444 U.S. 996 (1980). Any such reading of the statutory terms precludes the recharacterization which the IRS now seeks to effect.

The simple truth is that a bona fide interest-free demand loan was an inherently different transaction than a "transfer of property by gift" both to Congress and to the average American citizen in 1932. When such a loan was made, the lender had *not* given away his money or property; he expected it back and had the legal right to recover it in full whenever he chose to do so. Although the borrower might have made use of the money or property temporarily, he would never have claimed that he had received a "gift." Indeed, he likely would have protested any such assertion — he knew that he would have to pay back every cent borrowed.[6]

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[6]Similarly, judicial decisions of the period clearly distinguished between a gift and a loan. A "gift" involved an absolute and irrevocable transfer of property:

> The delivery of such a gift must be not only of possession, but also of dominion and control of the property. The title must be absolute and . . . must be so complete that if the donor again resumes control of it without the consent of the donee he becomes liable as a trespasser.

Grignon v. Shope, 100 Or. 611, 197 P. 317, 319 (1921). Accordingly, there was no gift where certificates of deposit were delivered by the transferor on the condition that "in case I need it you will have to give it to me; if I do not need it you will keep it." *Devine v. Stepanek*, 176 Ill. App. 61 (App. Ct. 1912). *Accord, Jones v. Luing*, 152 Iowa 276, 132 N.W. 371 (1911) (no gift where property transferred on condition that donor die without needing it); *Chamberlain v. Eddy*, 154 Mich. 593, 118 N.W. 499 (1908) (no gift where donor reserved the right to call back the property at any time before death).

The conclusion that Congress did not intend bona fide loans to result in taxable gifts also is confirmed by a consideration of the primary Congressional purpose in enacting the gift tax law: "to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death." *Sanford's Estate v. Commissioner*, 308 U.S. 39, 44 (1939). When a person makes a bona fide demand loan of property, there is no basis for assuming that the property will not be in his estate upon his death and subject to estate taxation. To the contrary, the loans typically will either be repaid during his lifetime or will be repaid upon a demand by his estate.[7] In either event, the loan is neutral with respect to the amount of his estate and the estate tax thereon — as it was in the case of Paul Dickman.[8] For this reason, there is no basis whatsoever for inferring that Congress intended to impose a gift tax in connection with such a loan.

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[7] The executor will have a fiduciary duty to demand repayment. *E.g.*, FLA. STAT. § 733.607 (1981); *Galatis v. Plasman*, 80 So. 2d 918 (Fla. 1955).

[8] No situation could more clearly illustrate both this fact and the typical lack of estate tax motivation of bona fide interest-free demand loans than that now before the Court. Although Paul and Esther Dickman had three grandchildren active in the business of Artesian, they made the loans to the business itself or to their son, Lyle (Pet. A. 18a). Lyle actually predeceased Paul, and his estate exceeded Paul's by far more than the amount of the loans to Lyle (Pet. A. 18a). If estate tax minimization had been Paul and Esther's objective, the loans logically would have been made to their grandchildren. Indeed, if the loans to Lyle resulted in any increase in his estate, the increase potentially was taxable in a higher bracket than that in which the same sums would have been taxed in Paul's estate. Moreover, the full value of the outstanding loans at Paul's death were taxed in his estate. The loans at issue therefore plainly were not designed to avoid the estate tax, and did not have that effect. Many intra-family loans are used by the borrower for business or personal purposes, rather than to earn interest or other passive investment income. For example, in this case, although Paul and Lyle were deceased at the time of trial and could not testify as to the use of the Loans, the fact that a portion of the Loans were made to the corporation certainly suggests that they were to be used in the corporation's business pursuits. It is difficult to understand why a gift tax based on imputed interest should be imposed on such loans for personal or business purposes.

It is the history of the administration of the gift tax law by the IRS, however, that provides perhaps the most convincing proof that Congress did not intend to impose a gift tax on bona fide interest-free demand loans. For over thirty years after enactment of the law, the IRS never took a position on record that an interest-free demand loan involved any taxable gift. It was only after decades of this practice, and without further Congressional guidance[9] or new regulations,[10] that such a claim was first advanced in *Johnson v. United States*, 254 F.Supp. 73 (N.D. Tex. 1966).

Johnson involved demand loans from parents to their two children, evidenced in part by promissory notes and in part by open accounts. The IRS imposed a gift tax based upon 3½ percent of the loan balances for each year at issue, contending that "Mr. and Mrs. Johnson made a gift to their children of the value of the use of the money." 254 F.Supp. at 73. The district

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[9] The conclusion that Congress historically has not intended bona fide loans to result in taxable "transfers of property by gift" is further supported by changes Congress made to the bad debt loss rules in the Revenue Act of 1942, ch. 619, 56 Stat 798 (1942). The Act created the statutory distinction between business and non-business bad debts, permitting only capital loss treatment for the latter. *Id.*, § 124(a). The relevant committee report uses examples of a loan to a friend or a relative to describe non-business debts, indicating that Congress was well aware of the common practice of such loans. H. REP. NO. 2333, 77th Cong., 2d Sess. 45 (1942), *reprinted in* 1942-2 C.B. 372, 408-09. Although Congress was not willing to permit an ordinary loss deduction in such instances, there was no suggestion that loans to friends or relatives might be considered to constitute "gifts," even after a total failure of repayment. Indeed Congress' allowance of a capital loss deduction in connection with such loans is irreconcilable with any recharacterization of them as "gifts," for which *no* income tax deduction would be permissible.

[10] The various Treasury Regulations under the gift tax law have never addressed interest-free or low-interest loans. Treas. Reg. 79 (U.S. Treas. Dept., Bureau of Internal Revenue, *Regulations 79, relating to Gift Tax under the Revenue Act of 1932* (1933), with periodic amendments); Treas. Reg. 108 (8 Fed. Reg. 10858 (1943), with periodic amendments); Treas. Reg. §§ 25.2501-1 — 25.7101-1 (T.D. 6334, 1958-2 C.B. 627, with periodic amendments).

court rejected the claim that these loans involved gifts within the meaning of I.R.C. § 2501, noting that the loans were genuine and had been substantially repaid prior to Mr. Johnson's death.

In reaching this decision, the court relied upon two primary considerations, each of which is fully applicable here. First, the court emphasized that interest-free loans do not reduce the amount of the lender's estate. In fact, in *Johnson*, as in this case, "the unpaid amount of the loans appeared on the books, and was includible as an asset of [Mr. Johnson's] estate in arriving at the amount of his estate taxes." 254 F.Supp. at 77. The only effect of such loans on the estate tax is that the lenders *might* have used their funds so as to generate income, which they *might* not have consumed in some way; if so, their estates would have been greater. The court concluded that deterring reduction of the theoretical potential estate, as opposed to the actual estate, was not within the purposes of the gift tax law. Second, the court recognized that any expansion of the gift tax like that sought by the IRS should not be attempted through the judicial process: "Passage of a law providing for a tax like the one here contended for should be sought through Congress instead of the courts." 254 F. Supp. at 77.

The IRS chose in 1966 not to appeal the *Johnson* decision and did not indicate its disagreement with it nor seek any Congressional action to overrule it. In the years following *Johnson*, cases appeared in which the IRS appeared to abandon its position in *Johnson*. For example, in *Small v. Commissioner*, 28 T.C.M. (CCH) 1111 (1969), the court found that a transfer of property in return for promissory notes bearing no interest constituted a taxable gift to the extent that the fair market value of the property exceeded the buyer's principal obligation under the notes. There was no claim by the IRS, however, that the

alleged gifts should be increased because of the interest-free characteristic of the notes.[11]

Such was the state of the law in 1971, the first year in which the IRS claims Paul and Esther Dickman owed gift taxes for the loans at issue here. In 1973, however, the IRS announced its disagreement with the seven-year old *Johnson* decision, and reasserted its position which was rejected in that case. In Rev. Rul. 73-61, 1973-1 C.B. 408, it stated that an interest-free demand note results in a taxable gift. Although admitting that "the value of the right to the use of the money loaned was not ascertainable at the date of the exchange," 1973-1 C.B. at 409, the IRS contended that the value of the taxable gift could be assessed on the last day of each calendar quarter during which the borrower had had use of the money.[12] No specific method for

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[11] *Accord, Estate of Kelley v. Commissioner*, 63 T.C. 321 (1974), *acq. and nonacq.*, 1977-2 C.B. 2. In *Estate of Lang v. Commissioner*, 64 T.C. 404 (1975), *acq.*, 1981-2 C.B. 2, *aff'd in part and rev'd in part*, 613 F.2d 770 (9th Cir. 1980), the IRS successfully claimed that a taxable gift of the principal of interest-free notes executed from 1962 to 1967 was made when the taxpayer permitted the statute of limitations to run on suit on the notes. Again, the IRS made no contention that gifts were made during the life of the notes because they bore no interest. In *Republic Petroleum Corp. v. United States*, 397 F.Supp. 900, 917-18 (E.D. La. 1975), *aff'd in part and rev'd in part*, 613 F.2d 518 (5th Cir. 1980), the IRS argued that cancellation of interest at a rate of two percent on a loan constituted a taxable gift. There was no claim, however, that the two percent rate was not full and adequate consideration for the loan, and thus in itself a taxable gift of the use of money.

[12] For calendar years prior to 1971, a donor was required to file a gift tax return for any calendar year in which he made a transfer of a future interest in property or of a present interest to any one donee exceeding $3,000 in value. Between 1971 and 1981, gift tax returns were due on a calendar quarter basis, beginning with the quarter in which the donor made a transfer of a future interest or a present interest in excess of $3,000. The annual filing requirement was reinstated in 1982 in lieu of quarterly filings. I.R.C. § 6019(a), *as amended by* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 403(b)(3)(A), 95 Stat. 172 (1981). At the same time, the annual exclusion amount of $3,000 was increased to $10,000. I.R.C. § 2503(b), *as amended by* Economic Recovery Tax Act of 1981, *supra*, § 441(a).

assessing such value was suggested; the IRS stated only that, although the value was "usually stated in terms of interest or some other equivalent in money or money's worth," the appropriate rate of interest "may vary, depending upon the actual circumstances pertaining to the transaction." 1973-1 C.B. at 409.

The IRS first sought to invoke Rev. Rul. 73-61 in the Tax Court in *Crown v. Commissioner*, 67 T.C. 1060 (1977), *aff'd*, 585 F.2d 234 (7th Cir. 1978). There, the IRS claimed that substantial interest-free demand loans from a partnership to trusts for the benefit of the partners' children and other relatives constituted taxable gifts. It sought to value the alleged gifts by applying a six percent interest rate to the loan balances, a rate that was slightly above the prime rate of interest and deemed "reasonable" by the IRS.

The Tax Court stated its agreement with the *Johnson* decision and rejected the position of the IRS and Rev. Rul. 73-61. After reviewing the reasoning of the court in *Johnson*, the Tax Court stated:

> The Commissioner was concerned . . . that the ultimate estate would be reduced by the amounts of money which the lender *could have* earned with the loaned funds during the period of the loans. However, that approach was properly rejected by the District Court because our income tax system does not recognize unrealized earnings or accumulations of wealth and no taxpayer is under any obligation to continuously invest his money for a profit. The opportunity cost of either letting one's money remain idle or suffering a loss from an unwise investment is not taxable merely because a profit *could have been made* from a wise investment.

67 T.C. at 1063-64.

As in *Johnson*, the Tax Court in *Crown* suggested that Congressional action should be forthcoming before such loans could be subjected to taxation. *Id.* But the Tax Court noted the substantial practical difficulties which might counsel against such legislation:

> Moreover, there are policy considerations which militate against viewing the value use of money or property as a taxable event for gift tax purposes. If respondent's position herein were sustained, the principle established could be extended to a multitude of situations involving gratuitous use or sharing of real or personal property among relatives. The application of the gift tax to common intrafamily sharing of use of property seems administratively unmanageable, and such situations point up the difficulty with the concept of gift taxation attaching to mere permissive use. Thus, we are inclined to follow in this area Justice Holmes' admonition that "a page of history is worth a volume of logic." *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).

67 T.C. at 1065.

The IRS appealed, but the Seventh Circuit Court of Appeals affirmed the Tax Court's decision. *Crown v. Commissioner*, 585 F.2d 234 (7th Cir. 1978). After examining at length several economic arguments for taxing the right to use money, the Seventh Circuit concluded that an interest-free demand loan could not fairly be characterized as a "transfer of property by gift" within the meaning of the gift tax statute. Again, the Court noted the serious difficulties with judicial, rather than legislative, acceptance of the claim of the IRS:

> Another problem with adopting the judicial construction urged by the Commissioner is the extremely broad potential reach of the principles that would be at least implicitly recognized. The same reasoning that leads to the finding of

> a taxable gift when $18 million is loaned by a parent to his children for investment purposes would find a gift where a father lends a thousand dollars to his son graduating from college until he can get established, or even where an office worker lends a fellow employee $10 "until next payday." Similar reasoning might find the presence of a gift when a neighbor borrows your lawnmower and fails to return it immediately, or when out-of-town guests are provided a night's lodging by friends instead of going to a hotel. As in Section 483, it might be desirable to set out a clear set of rules exempting from taxation certain types of property and/or transactions below some threshold duration or dollar value.

585 F.2d at 241 (footnote omitted).

Again, the IRS chose neither to seek further review of the decision against it nor to recommend alteration of the gift tax statute by Congress, and no regulations on the subject of such loans were promulgated. Instead, the IRS inadvertently demonstrated the validity of the Seventh Circuit's concern with the absence of legislative guidance by imposing a tax on the Dickmans in this case based on an entirely different rate of interest than that which it asserted in *Crown* or in *Johnson* — the rate prescribed by I.R.C. § 6621 and applicable to determine interest due on underpayments or refunds of tax. The Tax Court in this case reaffirmed its previous decision in *Crown*, but the Eleventh Circuit Court of Appeals reversed the Tax Court's decision.

Thus, prior to the decision of the Court of Appeals below, the fifty-one year history of the gift tax law could be divided into two periods. In the first period of more than thirty years, interest-free demand loans were common but there is no evidence that either Congress or the IRS believed them to have any gift tax consequences. In the second period of less than twenty years, the

IRS tried on several occasions without success to subject such transactions to gift taxation, without any change in the original statutory provisions. Despite its uniform lack of success in this era, the IRS neglected or refused to take its case to Congress. And Congress, presumably with knowledge of these decisions, amended the gift tax law during this latter period on eight occasions, twice in 1966, and once in 1969, 1970, 1974, 1976, 1978 and 1981.[13] It made no change whatsoever in the basic scope of the gift tax, nor otherwise indicated any disapproval of the court decisions holding that the law did not subject interest-free demand loans to gift taxation.

As this Court has noted, Congress is presumed to be aware of judicial interpretations of a statute and to adopt such interpretations when the statute is re-enacted without material change. *E.g., Lorillard, Inc. v. Pons*, 434 U.S. 575, 580 (1978); *Electric Storage Battery Co. v. Shimadzu*, 307 U.S. 5, 14 (1939). Here, this presumption is bolstered by the long-standing practice of the IRS prior to the mid-1960's, and after *Johnson* until 1973, of not attempting to impose the gift tax in connection with interest-free demand loans. In such instances, this Court properly has been most reluctant to accept any IRS contention that Congress intended something other than what has long been

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[13] Tax Treatment of Certain Payments, Pub. L. No. 89-365, 80 Stat. 32 (1966); Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539 (1966); Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969); Excise, Estate, and Gift Tax Adjustment Act of 1970, Pub. L. No. 91-614, 84 Stat. 1836 (1970); Internal Revenue Code Amendments, Etc., Pub. L. No. 93-625, 88 Stat. 2108 (1974); Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976); Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981). Five of these statutes amended I.R.C. § 2501 itself, the section which imposes the gift tax. Pub. L. No. 89-809, § 109(a); Pub. L. No. 91-614, § 102(a)(1), (2); Pub. L. No. 93-625, § 14(a); Pub. L. No. 94-455, §§ 1902(a)(10), (c)(1), 1906(b)(13)(A); and Pub. L. No. 97-34, § 442(a)(1).

Additionally, technical amendments were made to the gift tax law by the Technical Corrections Act of 1982, Pub. L. No. 97-448, § 104(a), 96 Stat. 2365 (1983), which although formally enacted as part of the Act after the decision of the Court of Appeals below, were approved (without subsequent change) by the Senate Finance (Sept. 27, 1982) and House Ways and Means (Sept. 8, 1982) Committees before that decision (Nov. 1, 1982).

reflected in judicial decisions and administrative practice. *See Fribourg Navigation Co. v. Commissioner*, 383 U.S. 272, 279-81 (1966); *United States v. Davis*, 370 U.S. 65, 71 (1962).

In the circumstances presented in this case, the conclusion which should be reached from the history of the gift tax statute and its administration is that the Congress has at no time intended to impose gift taxation in connection with interest-free demand loans.

B. Interest-Free Demand Loans Are Not "Transfers of Property by Gift."

It is the duty of this Court, of course, to interpret the tax statutes as they are written, interpreting the words used by Congress literally and in accordance with their ordinary, everyday meaning. *E.g., United States v. Byrum*, 408 U.S. 125, 136-37 (1972); *Commissioner v. Korell*, 339 U.S. 619, 627-28 (1950); *Crane v. Commissioner*, 331 U.S. 1,6 (1947). In so doing, courts will not extend the tax statutes by implication for the purpose of maximizing revenues for the government. *See, e.g., Caruth v. United States*, 566 F.2d 901, 904 (5th Cir. 1978). Indeed, this Court has refused to do so even when the result otherwise was a "windfall" to the taxpayer as a result of a "major tax loophole." *Hanover Bank v. Commissioner*, 369 U.S. 672, 682, 687-88 (1962); *Lewyt Corp. v. Commissioner*, 349 U.S. 237, 240 (1955). Where doubt truly exists as to the application or meaning of a statute, it must be construed strictly against the government and in favor of the taxpayer. *E.g., Gould v. Gould*, 245 U.S. 151, 152 (1917); *Peters v. United States*, 624 F.2d 1020, 1028 (Ct. Cl. 1980).

Viewed in light of these principles, it cannot fairly be concluded that a bona fide interest-free demand loan constitutes a "transfer of property by gift." Initially, it is undeniable that the

only "transfer," as that term is commonly used, which Paul or Esther Dickman made in this case was the "transfer" of money to Lyle or Artesian at the time that they made each demand loan. The IRS does not and cannot, however, claim that this transfer itself was an event subject to gift tax at that time as no "transfer of property by gift" had then occurred. *See* Rev. Rul. 73-61, 1973-1 C.B. 408. That transfer itself plainly did not convey to the borrower any right to use the money loaned for a definite period of time, or even for more than an instant. The lender was free to demand repayment prior to any effective use of the property by the borrower whatsoever. It was not the transfer of money, but only the failure to reclaim it over time, which could have any substantial value to the borrower or result in any substantial detriment to the lender.

Thus, it is clear that the IRS cannot effectively subject the making of the loan itself, the only "transfer of property" involved, to gift taxation. Any effort to do so, by artificially characterizing the loan as a transfer of money in return for a promise to repay that has a value less than the money transferred — an "unequal exchange" — must be rejected here for the same reasons stated by the Seventh Circuit in *Crown*. The gift tax law specifically provides that a "transfer of property by gift" must be valued for tax purposes "at the date of the gift." I.R.C. § 2512(a). Moreover, the Treasury Regulations require that "value" be determined by a marketplace standard reflecting the exchangeable value of the property transferred as of that date: "[T]he price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts." Treas. Reg. § 25.2512-1. As the *Crown* court noted, however:

> [F]rom a realistic point of view the value at the time the loan is extended of the right to repayment is both unknown

> and unknowable. The Commissioner has not produced any evidence showing that demand notes systematically trade at a significant discount from face value in the market place. Nor can a present discounted value formula be successfully applied given the absence of knowledge as to when the loan will be repaid. The most that can be said is that the eventual value of the notes expressed in terms of a present discounted value as of the time of the loan will range somewhere between zero and the face amount of the notes.

585 F.2d at 238 (footnotes omitted).[14] Thus, the characterization of an interest-free demand loan according to the "unequal exchange" theory of the IRS necessarily leads to a conclusion that there has been no "transfer of property by gift" under the gift tax law.[15]

An alternative IRS theory — one adopted by the Court of Appeals below (Pet. A. 11a-12a) — contains within it the same fatal flaw. This theory is that the making of an interest-free demand loan constitutes a present transfer of the "right to use property." Putting aside for a moment questions as to the

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[14] It should be noted that even these broad statements necessarily are based upon some economic assumptions that are not universally valid. In a society in which deposits in savings institutions are neither safe nor insured and economic conditions are highly unstable, a secure interest-free demand loan may have a greater value than interest-bearing bank deposits or less secure interest-bearing loans. While such economic circumstances may seem entirely unrealistic to us, they were not so unrealistic to the Congress which enacted the gift tax law on June 6, 1932, a year in which both prices and interest rates in the United States were falling. U.S. DEPARTMENT OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES; COLONIAL TIMES TO 1970; PART 1 211 (1975); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, BANKING AND MONETARY STATISTICS 1914-1941 464 (1976).

[15] Certainly the retroactive valuation method espoused by the IRS — valuing the "gift" only as of the end of a period in which a loan has been outstanding — is irreconcilable with any theory that the making of an interest-free demand loan is itself a "gift," because valuation must be made under I.R.C. § 2512(a) "at the date of the gift."

validity of this characterization, the fact remains that this alleged "transfer of property" inherently has no measurable value at the date specified in the gift tax law as the one upon which the value of the gift must be measured — "the date of the gift." I.R.C § 2512(a). This is because the mere *use* of property has value *only* over time; unless there is some advance assurance that the use will continue for some period of time, the right to such use has no ascertainable value at its outset.

Thus, under either of these characterizations of the only "transfer" involved in making an interest-free demand loan, such a loan has no value under the present gift tax law which fixes both the time and the method for valuing gifts.

A third theory for treating interest-free demand loans as gifts, just as unavailing, has been advanced by the IRS. Under this theory, taxable transfers of the use of property, which allegedly is "property itself," occur continuously during a calendar quarter in which no demand for repayment of a demand loan is made. This theory, however, is at war with any ordinary concept of the term "transfer." That term connotes a discrete, affirmative act whereby a person conveys something to another person, not a continuous series of minute failures to require return of something loaned. There is no basis for concluding that such non-action is a "transfer" of property in the usual sense of that term — the sense in which we must conclude it was used by Congress.[16]

Similarly, whatever the borrower may have in a demand loan situation, it is not "property" as that term is ordinarily used. As this Court stated in *Crane v. Commissioner*, 331 U.S. 1, 6 (1947) (footnotes omitted):

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[16] In addition, to value such a "transfer" after the fact based on interest rates which were in effect during the calendar quarter is to ignore the demand feature of the loan. The borrower would have had to have been assured of the right to use the property for the calendar quarter in order for the loan to have had such a value when made.

> [T]he words of statutes — including revenue acts — should be interpreted where possible in their ordinary, everyday senses. The only relevant definitions of "property" to be found in the principal standard dictionaries are the two favored by the Commissioner, i.e., either that "property" is the physical thing which is a subject of ownership, or that it is the aggregate of the owner's rights to control and dispose of that thing.

We can readily concede that Congress in the gift tax law intended to encompass within the term "property" something more than "the physical thing." It intended to include the many kinds of intangible property long recognized by the law, such as choses in action, copyrights and accounts receivable. *See* I.R.C. § 2511(a). It intended to include equitable as well as legal interests, and property "however conceptual or contingent." *Smith v. Shaughnessy*, 318 U.S. 176, 180 (1943). *See also Commissioner v. Wemyss*, 324 U.S. 303 (1945). But it did *not* intend to elevate to the status of "property" every bare incident of property — such as the momentary use of property at the will of another. Such an incident of property is only a minute sliver of "the aggregate of the owner's rights to control and dispose" of that which he owns; it is not "property" itself in the ordinary sense.

This is shown most clearly by the statements of the Committees which reported the gift tax law to the House and Senate and which often have been cited as illustrative of the breadth of the reach of the law: "the term 'property' reaching every species of right or interest protected by law and having an exchangeable value." S. REP. NO. 665, 72nd Cong., 1st Sess. 39 (1932), *reprinted in* 1939-1 C.B. (Part 2) 496, 524; H. REP. NO. 708, 72nd Cong., 1st Sess. 27 (1932), *reprinted in* 1939-1 C.B. (Part 2) 457, 476. As broad as is this definition, it cannot extend, as the IRS would extend it, to every economic benefit

which one may have as a result of the act or omission of another. Specifically, it cannot be extended to encompass the "right to use money" pursuant to a demand loan, which the IRS claims is "property itself." Such a "right" is not protected by law in any respect. It may be withdrawn by the lender at any time for any reason or no reason, and the law will not impede that withdrawal under any circumstances. Indeed, the IRS's argument that such a "right" is "property itself" is an *ignis fatuus* which, in the absence of delineation by Congress, should be given no effect in our tax law.

C. "Property" Cannot be Equated to "Opportunity for Economic Benefit."

The attempt of the IRS to subject interest-free demand loans to gift taxation apparently is attributable to a desire to ensure that all means by which any opportunities for economic benefit pass between family members are subjected to the gift tax. The IRS is well aware of, and often emphasizes, the principle that a taxable gift may occur without the presence of every element of a common law gift, such as donative intent. *E.g. Fondren v. Commissioner*, 324 U.S. 18, 28 (1945). It also is aware that "the essence of a transfer is the passage of control over the economic benefits of property rather than any technical changes in its title." *Sanford's Estate v. Commissioner*, 308 U.S. 39, 43 (1939), *citing Burnet v. Guggenheim*, 288 U.S. 280, 287 (1933). What has been lost sight of, however, is that the tax still is imposed, as it was in 1932, upon the transfer of *property*, and not of mere economic benefit or the opportunity for such benefit. The two are not synonymous.

This principle is perhaps made most apparent by Justice Stone's opinion in *Bromley v. McCaughn*, 280 U.S. 124 (1929), in which the Court upheld the constitutionality of the 1924 gift tax statute, which imposed a tax on " 'the transfer . . . by

gift' . . . 'of any property wherever situated.' " 280 U.S. at 135. Justice Stone made it clear that not every exercise of property rights which provides actual or potential economic benefit to another is subject to tax, but only a single one:

> [The gift tax] is a tax laid only upon the exercise of a single one of those powers incident to ownership, the power to give the property owned to another. Under this statute all the other rights and powers which collectively constitute property or ownership may be fully enjoyed free of the tax.

280 U.S. at 136-37. While it is true that an interest-free demand loan involves a "transfer," such "transfer" is a transfer by loan, not a transfer by gift. Thus, the power to lend property to another, or the unexercised power to charge interest or rental for its temporary use, were never the subject of the gift tax — even though the result might be some economic benefit to others.

Similarly, it cannot seriously be contended that Congress sought to tax the gift of valuable personal services provided within a family, despite the undeniable economic benefit which is thereby provided. For example, the IRS itself recognizes that an executor of an estate who waives fees or commissions — thereby saving money for the estate which passes to his son — makes no gift for gift tax purposes. Rev. Rul. 66-167, 1966-1 C.B. 20. *See* Rev. Rul. 70-237, 1970-1 C.B. 13. In *Commissioner v. Hogle*, 165 F.2d 352 (10th Cir. 1947), the court found no taxable gift where a taxpayer served without compensation as trustee of securities trading accounts for his children: "What, in fact and in reality, Hogle gave to the trusts in the taxable years was his expert services . . . . [T]here was no transfer directly or indirectly by Hogle to the trusts of property or property rights." 165 F.2d at 353-54.

When a lawyer writes a contract or will for his brother, when a doctor treats her adult daughter for illness, or when a skilled craftsman teaches his trade to his son, who can doubt that

economic benefit has passed? The provider of the benefit has foregone income which could have been earned by otherwise using his resources for profit, and the recipient has received something of value which otherwise would have cost substantial sums. Indeed, in the instance of the craftsman, the resulting economic benefits to the recipient may be lifelong and very great.

If the sole objective of the gift tax law is to ferret out the passage of economic benefit within families and subject it to tax, then each of these examples undeniably is a transaction which must be taxed. In the words of Judge Fay's concurrence in the Eleventh Circuit's decision below, the taxpayers in such instances "have given away no property, no interests, and no rights, but surely they have made a gift" (Pet. A. 13a). However, the fact that such provisions of benefit are not within the terms of the statute and have never been claimed to be taxable as a gift by Congress or the IRS demonstrates clearly that the passage of "economic benefit" within families is not the sole or even a sufficient condition for the imposition of gift tax.[17]

Thus, the argument of the IRS that similar economic benefits might have been passed to the borrowers with taxable results simply misses the point, as the Seventh Circuit in *Crown* noted. 585 F.2d at 237. Congress may someday choose to impose a gift tax upon all acts, or failures to act, which cause any type of economic benefit to pass to another for less than full consideration. Congress has not yet done so, however, and the IRS' contention in this case must be rejected since it is based on the erroneous premise that such is now the state of the law. Until the day when Congress adopts such a sweeping statute, citizens will be free to make use of their knowledge, their talents, and their property so as to benefit their children and close relatives

[17] This is also true in the income tax area. "Despite the importance of imputed income from services performed by taxpayers and their families, Congress has never sought to tax this source of economic gain." B. BITTKER, FEDERAL INCOME TAXATION OF INCOME, ESTATES AND GIFTS ¶ 5.3.2, p. 5-25 (1981).

without tax, so long as they do not "give the property owned to another." *Bromley v. McCaughn*, 280 U.S. at 136-37. They may do so with confidence that their actions will be given tax effect based on what actually was done, and not based on what might have been done.[18] *Central Tablet Manufacturing Co. v. United States*, 417 U.S. 673, 690 (1974); *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148 (1974). Because Paul and Esther Dickman did not give their property to others, they owe no tax under the gift tax law as presently written.[19]

D. Taxation of Interest-Free Demand Loans as "Transfers of Property By Gift" Is Irreconcilable with Prior Positions of the IRS and Other Tax Law Provisions.

The earliest statement of the IRS with respect to interest-free loans was in Rev. Rul. 55-713, 1955-2 C.B. 23, involving imposition of income tax in connection with split-dollar life

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[18] This does not, of course, mean that the IRS must exalt form above substance and refrain from imposition of gift tax on every transaction cast as a loan. When a "loan" is in reality a gift, it may be taxed as such under the "sham transaction" or "economic substance" doctrines or related principles which this Court has clearly recognized. *E.g., Gregory v. Helvering*, 293 U.S. 465 (1935). This clearly is not such a case, and the IRS has made no claim to the contrary. *See* n. 2 *supra*. Even in such a case, however, the gift would be of the principal "loaned," not of some amount of claimed "interest." *See Estate of Kelley v. Commissioner*, 63 T.C. 321 (1974), *acq. and nonacq.*, 1977-2 C.B. 2; *Small v. Commissioner*, 28 T.C.M. (CCH) 1111 (1969).

[19] It is this failure to recognize the difference between the interpretation and enforcement of the gift tax statute as written by Congress, and the enforcement of a supposed policy to tax every type of event by which the opportunity for economic benefit is passed within a family, that lies at the heart of the decision of the Court of Appeals below. Judge Fay's very candid concurring opinion clearly reflected this approach:

> Taxpayers have given away no property, no interests and no rights but surely they have made a gift. Judge Hill has labored hard to find some "legal support" for this conclusion. When one lets another use large sums of money for no charge, who would doubt that there has been conferred a valuable gift? . . . Feeling that courts should avoid "slavish" interpretation of the Code . . . I join with Judge Hill.

(Pet. A. 13a-14a).

insurance, which was regarded as similar to an interest-free loan from the employer to the employees. The Ruling stated that "[t]he mere making available of money does not result in realized income to the payee or a deduction to the payor."[20]

In *Dean v. Commissioner*, 35 T.C. 1083 (1963), *nonacq.*, 1973-2 C.B. 4, the Tax Court decided a case involving interest-free loans of over $2,000,000 from a corporation to the taxpayers who were its predominant shareholders. The IRS claimed that the interest-free loans resulted in income to the taxpayers, measurable at the prime rate of interest, but the Tax Court rejected the contention: [W]e have not been directed to any case holding or even suggesting that an interest-free loan may result in the realization of taxable income by the debtor . . . ." 35 T.C. at 1089. The *Dean* case has since become the rule in the First, Second, Fourth, Fifth, Sixth, and Ninth Circuits.[21] Sporadic attempts by the IRS to impose tax on theoretical interest income to the lender in interest-free loans also have been rejected. *Brandtjen v. Kluge, Inc.* 34 T.C. 416 (1960), *acq.*, 1960-2 C.B. 4; *Society Brand Clothes, Inc. v. Commissioner*, 18 T.C. 304 (1952), *acq.*, 1952-2 C.B. 3; *Combs Lumber Co. v. Commissioner*, 41 B.T.A. 339 (1940), *acq.*, 1940-1 C.B. 2.

The law with respect to charitable deductions for income tax purposes is different from the gift tax law in that any "charitable

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[20] Rev. Rul. 55-713, 1955-2 C.B. 23, 24. The ruling was revoked and replaced by Rev. Rul. 64-328, 1964-2 C.B. 11, after the IRS concluded that split-dollar insurance plans were not the same as interest-free loans and analyzed their tax consequences in a different manner. Rev. Rul. 64-328, however, did not announce any alteration in the IRS' 1955 position as to the nontaxable consequences of interest-free loans.

[21] *Parks v. Commissioner*, 686 F.2d 408 (6th Cir. 1982); *Baker v. Commissioner*, 677 F.2d 11 (2d Cir. 1982); *Commissioner v. Greenspun*, 670 F.2d 123 (9th Cir. 1982); *Beaton v. Commissioner*, 664 F.2d 315 (1st Cir. 1981); *Martin v. Commissioner*, 649 F.2d 1133 (5th Cir. 1981); *Suttle v. Commissioner*, 625 F.2d 1127 (4th Cir. 1980). Only a trial judge in the Court of Claims has accepted the stubborn contention of the IRS in this regard. *Hardee v. United States*, 82-2 U.S.T.C. (CCH) ¶ 9459 (Ct. Cl. 1982), *appeal pending* (Fed. Cir.).

contribution" is deductible; no "transfer of property" is necessarily required.[22] Nevertheless, the IRS long took the position that a taxpayer was not entitled to a charitable deduction for permitting a charity to use his property, even for a substantial and fixed period. In I.T. 3918, 1948-2 C.B. 33, 34, the IRS claimed that the right to use property was not itself property, but only a "privilege": "[P]ermission to use and occupy property granted to [a charitable] organization . . . does not constitute a gift of property. It is merely the granting of a privilege for which no charge is made." In several cases since then, the IRS consistently, albeit unsuccessfully, argued that no charitable deduction was permissible because a right to the use of property even for a definite period was not "property."[23]

In the Tax Reform Act of 1969, the Congress made clear its intended result for the future in the charitable deduction area. The Act added new I.R.C. § 170(f)(3)(A)[24] to provide that an

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[22] I.R.C. § 170(a), (c). Moreover, Congress has long encouraged gifts to charity, and the Courts have held that the charitable contribution provisions should be interpreted liberally for this reason. *E.g., Old Colony Trust Co. v. Commissioner*, 301 U.S. 379, 384 (1937).

[23] *Threlfall v. United States*, 302 F.Supp. 1114 (W.D. Wis. 1969) (two and one-half months rent-free use of office building); *Passailaigue v. United States*, 224 F.Supp. 682 (M.D. Ga. 1963) (rent-free lease terminable on fifteen days' notice); *Thriftimart, Inc. v. Commissioner*, 59 T.C. 598 (1973), *acq.*, 1973-2 C.B. 4 (three-year rent-free lease on office building subject to revocation on sixty days' notice if owner sold building); *Allen v. Commissioner*, 57 T.C. 12 (1971) (five-year rent-free lease of land); *Sullivan v. Commissioner*, 16 T.C. 228 (1951), *acq.*, 1951-1 C.B. 3 (use of real estate to terminate at end of World War II). The Eleventh Circuit erroneously cited these cases and *Abbott v. United States*, 74-2 U.S.T.C. (CCH) ¶ 13,040 (S.D. Miss. 1974), suggesting that an interest-free demand loan constitutes "property" (Pet. App. 5a-6a). None of the cases, however, involved instantly terminable interests like a demand loan. In *Passailaigue*, where the interest could be terminated on fifteen days' notice, the court regarded the situation as "substantially the same as that presented in *Sullivan*" — where the use was for the duration of World War II. 224 F.Supp. at 687.

[24] Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a)(1), 83 Stat. 487 (1969).

interest-free loan of money to a charity is not a sufficient transfer of the taxpayer's interest in the money to warrant a charitable contribution deduction. As stated by the IRS in Example (3) of Treas. Reg. § 1.170A-7(d):

> In 1971, D loans $10,000 in cash to a charitable organization and does not require the organization to pay any interest for the use of the money. Since D's contribution consists of a partial interest to which Section 170(f)(3)(A) applies, he is not entitled to a charitable contributions deduction . . . .

To appreciate the anomalies in the tax laws that would be created if this Court accepted the contention of the IRS here, one need only consider the case of an interest-free loan to a recognized charity. Under the gift tax laws, an outright gift of property or money to a charitable organization is taxable, but a gift tax charitable deduction exists under I.R.C. § 2522, so that there is no net gift and hence no gift tax. Under I.R.C. § 2522(c), however, the maker of an interest-free loan is not entitled to such a deduction. Thus, if this Court were to uphold the contention of the IRS here, an interest-free loan to the American Red Cross would result in a taxable gift, unrelieved by any deduction, and a gift tax would be payable. If the taxpayer simply gave the money to the American Red Cross, a charitable deduction from the taxable gift would be allowed under I.R.C. § 2522 and there would be no gift tax. In terms of the purposes of the gift tax statute, in terms of Congressional intent, and in terms of simple equity, such a difference in tax result would plainly be without justification. In interpreting a statute, the Court "should be slow to attribute to Congress a purpose producing such unequal treatment among taxpayers, resting on no rational foundation." *United States v. Gilmore*, 372 U.S. 39, 48 (1963).

Finally, imposition of a gift tax in connection with interest-free demand loans would be irreconcilable with a basic principle recognized by the Tax Court:

> [O]ur income tax system does not recognize unrealized earnings or accumulations of wealth and no taxpayer is under any obligation to continuously invest his money for a profit. The opportunity cost of either letting one's money remain idle or suffering a loss from an unwise investment is not taxable merely because a profit *could have been made* from a wise investment.

Crown v. Commissioner, 67 T.C. at 1063-64. Gift taxation of interest-free demand loan transactions can only be based upon a premise that such loans permit taxpayers to diminish not their actual estates or incomes, but their potential estates or incomes, and that such diminution may properly be discouraged or burdened by taxation. That premise is one that not only cannot be found in the gift tax law; it is one that finds no support in our estate or income tax laws either.

Had Paul and Esther Dickman invested the money which they loaned to Lyle and Artesian, they would have paid income tax on any profits they made and estate tax on any such profits which actually remained in their estates at their deaths. Had those investments not been profitable, they would not have paid income taxes on the "value of the right to use" the sums invested, nor would such an assumed "value" be included in their estates. We proceed in our tax system on the basis of what actually occurs rather than what might or could have occurred. We tax our citizens on their actual gains and losses, their actual estates and incomes. Unless this Court is now, by judicial decision, to depart from this basic principle, the contention of the IRS in this case cannot be accepted.

II. Adoption of the Contention of the IRS By This Court Would Result in Enormous Difficulties and Great Unfairness.

The breadth of the principle for which the IRS contends in this case is truly sweeping. If every occasion on which a person permits any use of his money or property for less than full consideration is a taxable gift, then taxable gifts are everywhere among us. Parents who permit their minor children to use any of the family's property have made a taxable gift to the extent that such use was not required to satisfy their legal obligation of support. Where children are permitted to go with their friends to the parent's vacation home in the summer, where a son is permitted to take the family car to a dance, and where a daughter is permitted to wear her mother's jewelry to that dance — all would be taxable gifts.

As to adult children or other relatives, *any* uncompensated use of their families' property would be taxable. The family who permits its twenty-one-year-old son to live at home in the summer during college has made a taxable "gift." A more sizable "gift" has been made by the couple who allows the widowed mother of one of them to live with them year-round. Any loan to adult children or to parents to help them through a difficult time would be within the same category.

The principle for which the IRS contends logically extends beyond interest-free loans, and would include every instance in which a person fails to maximize potential economic benefits. If a person on a drive with a friend is injured in an automobile accident because of the friend's negligence, a taxable "gift" would occur if the person chose to refrain from demanding full compensation from the friend. Where parents turn over management of the family business to their son and the business loses money because of his negligence, they would make a "gift" to him by not suing to recover the sums lost.

One need not consider such instances long in order to appreciate the burdens that such a state of the law would place on conscientious taxpayers. Each such "gift" would have to be noted, recorded, and somehow valued. In the common instance where a taxpayer has made true gifts to a child or other relative equal to or in excess of the annual exclusion amount ($3,000 in the years here at issue[25]), the taxpayer would be under the legal obligation to value and report to the IRS each and every use of his property by the donee for which he did not extract full market value. There would be a duty in such instance, enforceable by all of the sanctions available to the IRS, to report and value every weekend visit to the taxpayer's home, every outing in the taxpayer's car or boat, and even every loan of the taxpayer's lawn mower. I.R.C. § 6019.[26]

Our system of self-assessment simply cannot function in such a situation. In many and perhaps most instances, taxpayers would neglect to report such "gifts" either intentionally or because such transactions are so radically divergent from their conceptions of a taxable gift that they do not recognize any reporting obligation. In most instances, they would do so with impunity, because it would be impossible as a practical matter for the IRS to monitor the vast majority of such transactions. Any serious attempt to do so would intrude the IRS into everyday occurrences of family life to an extent that would be

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[25] The annual exclusion amount has been increased from $3,000 to $10,000 for 1982 and subsequent years. I.R.C. § 2503(b), *as amended by* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 441(a), 95 Stat. 172 (1981).

[26] This legal duty would even extend to the situation where parents make an interest-bearing demand loan to their daughter at a market rate, requiring the parties to carefully trace the ups and downs of the market rate during the year. If the market interest rate were to rise above the loan rate, the parents would have made a taxable gift to their daughter by not demanding payment so they could reinvest at a higher market rate. If the market interest rate were to fall below the loan rate the next week, the daughter would have made a taxable gift to the parents by not paying the loan and borrowing the money elsewhere at the lower market rate.

intolerable in our society. Indeed, the result would be wholly irreconcilable with our cherished conceptions of a zone of privacy into which government should not intrude even for the best of reasons.

The burdens of such a state of affairs would not be limited even to this extent. They would include tremendous difficulties of valuation, and a major increase in the amount of administrative and judicial effort required to resolve them. In the context of loans of money, there are difficulties which the IRS itself recognized in Rev. Rul. 73-61, 1973-1 C.B. 408: an appropriate rate of interest to be applied "may vary, depending upon the actual circumstances pertaining to the transaction." 1973-1 C.B. at 409. Under the gift tax law, value is measured by what the donor parts with, and not by what the donee receives. Treas. Reg. § 25.2511-2(a); *Bradford v. Commissioner*, 34 T.C. 1059, 1063 (1960), *acq.*, 1961-1 C.B. 4. In terms of the value of what the "donor" parts with, a demand loan is very different from a term loan. The lender parts with far more in a term loan than in a demand loan, where he has a right to recall the money to himself at any time he needs it or deems repayment to be insecure. Similarly, one borrower differs from another in ability to repay, and this affects the "value" of such a loan. Only an individualized process can take into account these and other factors which affect valuation, and that individualized process inevitably would involve tremendous effort, expense, and strain on administrative and judicial resources already overburdened by valuation and other disputes.[27]

An example of the great difficulties that would be entailed in valuing interest-free loans, and that are already beginning to clog our court system, is provided by a recently docketed Tax Court case, *LaRosa v. Commissioner*, No. 29632-82 (T.C., filed

[27] As of December 31, 1982, there was a backlog of 52,380 pending cases in the Tax Court, causing some taxpayers to wait at least a year and a half for their case to go to trial. The Wall Street Journal, Feb. 2, 1983, at 1, col. 5.

Dec. 22, 1982). In *LaRosa*, the IRS is asserting that the interest rates to be used to value the gift resulting from interest-free loans should fluctuate monthly. The IRS also is asserting that the applicable rates range up to 31.1 percent — interest rates that were "obtained by consulting with an expert witness." *LaRosa*, *supra*, Answer at ¶ 10. *LaRosa* spans five and one-half tax years and thus sixty-six calendar months. For each of these months testimony will be required to establish, at a minimum, market interest rates, local usury rates, the creditworthiness of the borrower as it changed from month to month, and any other appropriate adjustments called for by the circumstances. The difficulty of obtaining such information for periods that are five, ten or more years past will add to the burden.

To avoid these valuation burdens, the IRS would have to do what it did in the Tax Court and Court of Appeals below and in *Johnson* — ignore the necessity of individualized valuation in favor of the simple expedient of using one of the interest rates established in the Internal Revenue Code or the Treasury Regulations for another purpose. However, that choice serves only to emphasize, rather than conceal, the inherently arbitrary nature of any such crude benchmark. In *Johnson*, 254 F. Supp. at 76, the IRS used 3½ percent, the rate specified in the regulation tables then in effect for valuing annuities, life estates, terms for years, remainders, and reversions. Treas. Reg. § 25.2512-5 (T.D. 6334, 1958-2 C.B. 627, 653). In the instant case, the IRS used the interest rates established under I.R.C. § 6621 that were applicable for determining interest due on underpayments or refunds of tax for the years here involved, which ranged from 6 percent to 9 percent (Pet. A. 21a).[28] In yet a third arbitrary rate

[28] This theory would impose a 20 percent interest rate for loans outstanding in December 1982, Rev. Rul. 81-260, 1981-2 C.B. 244, a time when the prime rate was 11½ percent, 69 Federal Reserve Bulletin A27 (January 1983). Additionally, such 20 percent rate would violate some local usury laws. *E.g.*, FLA. STAT. § 687.02 (1981).

approach, in *Crown* the IRS simply asserted that a 6 percent rate was "reasonable" and therefore applicable. 67 T.C. at 1061.

These approaches have little or nothing to do with market measurements of value. Their inappropriateness is obvious, especially when it is remembered that Treas. Reg. § 25.2512-1 defines the measure of value to be used in determining the amount of a gift by reference to market transactions.

Further, the IRS' position would result in untenable anomalies with regard to interest-free loans to help a family member or friend pay college tuition or medical expenses. Under I.R.C. § 2503(e), payment of another person's college tuition or medical expenses is exempt from gift tax. If the IRS' position in this case is upheld, however, an interest-free loan made to that person to enable him to pay such expenses would result in a taxable gift. Thus families or friends wealthy enough to pay these expenses outright would not be subject to gift taxation while those who can only make a loan for the same purposes, because they will need the money later, would be subject to gift taxation. Congress cannot have intended such a result.

Another anomalous result is illustrated by considering an example involving a parent who has $25,000 and wishes to help her child through college and medical school. If the parent loans her child the $25,000 without interest and the IRS assumes an interest rate of twelve percent, the IRS would claim that "gifts" of $30,000 were made to the child if the parent demanded and obtained full repayment when the child was beginning his medical practice after ten years. If the parent instead simply gave the $25,000 to the child, however, the gift would only be in that lesser amount. It is obvious that the outright gift involves a more substantial gift and a greater diminution of the parent's estate than the bona fide loan. The theory of the IRS — which results in greater gift tax liability in the case of the loan — clearly is an erroneous one.

To these serious obstacles to any imposition of a tax on such transactions by judicial decision must be added the evident unfairness of that course to the Dickmans and thousands of other citizens who have made interest-free demand loans in the past. What was stated by the Seventh Circuit in *Crown* is equally true here:

> [O]ur hesitancy to adopt the result advocated by the Commissioner by judicial construction is reinforced by equitable considerations. *See Central Illinois Public Service Co. v. United States*, 435 U.S. 21, 98 S.Ct. 917, 55 L.Ed.2d 82 (1978) (Brennan, J., concurring). Although we recognize that the Commissioner has broad discretion in applying a ruling retroactively . . . the Commissioner has only recently begun to assert that the making of non-interest bearing loans is a taxable event, even though the statutory authorities offered in support of that position have been in existence since the creation of the gift tax laws. When the Commissioner's position on the same issue involved in the case at bar was squarely rejected by the court in *Johnson v. United States*, 254 F.Supp. 73 (N.D.Tex.1966), no appeal was taken. Moreover, the Commissioner's nonacquiescence in that decision was not made public until seven years later, six years after the alleged gifts now before us were made. Until that time there was no administrative or judicial authority suggesting that interest-free demand loans would give rise to a taxable gift.

585 F.2d at 241 (citation and footnote omitted).

In this case, tax on the interest-free demand loans at issue was first assessed for 1971, a time at which neither the Congress nor any court had indicated that any gift tax consequences would result. Indeed, until November, 1982, no taxpayer could find any court which had ever done other than directly reject such a contention. To impose such consequences retroactively on the many taxpayers who, like the Dickmans, have made bona fide

intra-family loans for reasons unrelated to tax avoidance would violate basic equitable principles which have been observed with respect to the tax laws both by the courts and by Congress. The area of estate and gift tax planning is one in which good faith reliance on precedents is particularly likely to occur. *See United States v. Byrum*, 408 U.S. 125, 134 n.8 (1972). As succinctly stated in *Central Illinois Public Service Co. v. United States*, 435 U.S. 21, 38 (1978) (Powell, J., concurring): "In view of the complexities of federal taxation, fundamental fairness should prompt the Commissioner to refrain from the retroactive assessment of a tax in the absence of such notice or of clear congressional authorization." *See also United States v. Mason*, 412 U.S. 391, 399-400 (1973); *United States v. Davis*, 370 U.S. 65, 71 (1962).

III. If Interest-Free Demand Loans are to be Subject to Gift Taxation, it is the Congress Which Should Impose Any Such Tax.

Every court which has considered the issue at bar, with the exception of the Court of Appeals below, has echoed a single conclusion — imposition of any gift tax in connection with interest-free demand loans is properly a matter for prospective legislative or administrative action, rather than for retroactive judicial decision.[29] *Crown v. Commissioner*, 585 F.2d at 240-41;

[29] The Tax Court's consistent conclusions on the issues presented here are entitled to special consideration by this Court. The Tax Court — with its resources already seriously overburdened — is the court which would bear much of the brunt of the greatly increased litigation which inevitably would follow any judicial adoption of the theories asserted by the IRS here. More importantly, the Tax Court's special expertise in interpretation of the tax laws has long been accorded respect by this and other courts. *Dobson v. Commissioner*, 320 U.S. 489, 502 (1943); *Abkco Industries, Inc. v. Commissioner*, 482 F.2d 150, 155 (3d Cir. 1973).

> Where the statute is so indecisive and the importance of a particular holding lies in its rational and harmonious relation to the general scheme

Johnson v. United States, 254 F.Supp. at 77; *Crown v. Commissioner*, 67 T.C. at 1064; *Dickman v. Commissioner*, Pet. A. at 24a.[30] The concerns that led these courts to that conclusion include those which have been discussed herein: the absence of any evidence that such a tax ever was within the intendment of Congress, the impossibility of arriving at any rational valuation for such a tax under existing law, the confusion and insuperable difficulties, administrative and otherwise, which would attend any judicial imposition of such a tax, and the serious unfairness to individual citizens which would necessarily result.

These concerns can be further illustrated by reference to the actions of Congress in analogous situations. In the 1960's, for example, the IRS argued that a portion of the payments received in interest-free installment sales should be treated as interest rather than sales proceeds. In *Brown v. Commissioner*, 37 T.C. 461 (1961), *aff'd*, 325 F.2d 313 (9th Cir. 1963), *aff'd*, 380 U.S. 563 (1965), and *Pretzer v. United States*, 61-1 U.S.T.C. (CCH) ¶ 9477 (D. Ariz. 1961), the courts rejected the Commissioner's claims. As noted in this Court's decision in *Brown*, 380 U.S. at 578 n.9, the IRS then turned to Congress to overturn what it felt was an improper result. Congress responded in 1964 with legislation contrary to the proposals of the IRS in several respects, but including, in I.R.C. § 483, a mechanism for treating

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> of the tax law, I think great deference is due the twice-expressed judgment of the Tax Court. . . . [T]he Tax Court is a more competent and steady influence toward a systematic body of tax law than our sporadic omnipotence in a field beset with invisible boomerangs.

Arrowsmith v. Commissioner, 344 U.S. 6, 12 (1952) (Jackson, J., dissenting).

[30] Similarly, each of the six United States Courts of Appeals that have considered the federal income tax consequences of interest-free loans have concluded that any such tax consequences should await Congressional action. *Parks v. Commissioner*, 686 F.2d 408 (6th Cir. 1982); *Baker v. Commissioner*, 677 F.2d 11 (2d Cir. 1982); *Commissioner v. Greenspun*, 670 F.2d 123 (9th Cir. 1982); *Beaton v. Commissioner*, 664 F.2d 315 (1st Cir. 1981); *Martin v. Commissioner*, 649 F.2d 1133 (5th Cir. 1981); *Suttle v. Commissioner*, 625 F.2d 1127 (4th Cir. 1980).

a portion of an installment sales price as interest in certain situations. It did so only after hearings which afforded to those affected an opportunity to voice their concerns. More importantly, it did so in a manner that illustrates the inherent advantages of comprehensive legislative treatment, for Congress excluded transactions which were limited in duration and scope, and added other rules, including "safe harbor" interest rates, to guide taxpayers considering installment transactions. *See* I.R.C. § 483(f); Treas. Reg. §1.483-1(c), (d).

If Congress wishes to impose a gift tax on interest-free demand loans, the incorporation of similar features would be desirable and practical. Of great significance is the fact that any such legislation would have an effective date and operate prospectively. Persons who have previously made interest-free demand loans would not be penalized retroactively for their actions and those who thereafter make such loans would do so with fair notice of their consequences. Moreover, Congress would almost certainly exclude from the reach of taxation a vast group of everyday transactions which plainly would be taxed if the broad rationale urged on this Court by the IRS were accepted. Finally, Congress could adopt specific and workable rules, including "safe harbor" interest rates, for the valuation of any loans or other uses of property which it determined to treat as "gifts."[31] Congressional action of this sort would well illustrate what this Court has long acknowledged:

> [T]he orderly way to eliminate error or discrimination, if any there be, is by legislation and not by court decision. Congressional processes are more accommodative, affording . . . hearings and an opportunity to assist in the formulation of new legislation. . . . The whole scope of congressional action would be known long in advance and

[31] It should be noted that this level of flexibility would be unavailable in instances of administrative as well as judicial actions, because such refinements necessarily require legislative authorization.

> effective dates for the legislation could be set in the future without the injustices of retroactivity and surprise which might follow court action.

Radovich v. National Football League, 352 U.S. 445, 452 (1957). These considerations are particularly appropriate in the field of tax law:

> Courts properly have been reluctant to depart from an interpretation of tax law which has been generally accepted when the departure could have potentially far-reaching consequences. When a principle of taxation requires reexamination, Congress is better equipped than a court to define precisely the type of conduct which results in tax consequences.

United States v. Byrum, 408 U.S. 125, 135 (1972).

The installment sales area is, of course, only one of many instances in which the courts have "deem[ed] it wise to 'leave to the Congress the fashioning of a rule which, in any event, must have wide ramifications.'" *Commissioner v. Brown*, 380 U.S. at 579, *quoting American Automobile Association v. United States*, 367 U.S. 687, 697 (1961). In some instances, Congress has specifically delegated to the IRS the authority to make regulations, prospective in effect, dealing with troublesome tax issues involving interest. For example, I.R.C. § 482 authorizes the IRS to distribute, apportion, or allocate gross income, deductions, credits, or allowances among commonly owned or controlled entities in certain circumstances. After an initial unsuccessful effort by the IRS to impute interest income to a subsidiary on interest-free loans to its parent, *Smith-Bridgman & Co. v. Commissioner*, 16 T.C. 287 (1951), *acq.*, 1951-1 C.B. 3, *clarified in* Rev. Rul. 67-79, 1967-1 C.B. 117, Congress directed the Treasury to consider development of specific regulations on

the subject. H. REP. NO. 2508, 87th Cong., 2d Sess. 19 (1962), *reprinted in* 1962-3 C.B. 1129, 1146-47. Regulations were proposed and, after public hearings, revised and finalized. The result again was a comprehensive treatment of the issue, with specific rules arrived at with public participation, affording a clear prospective guide for taxpayer conduct. Treas. Reg. §§ 1.482-1(d), 1.482-2 (proposed, 30 Fed. Reg. 4256 (1965); reproposed, 31 Fed. Reg. 10294 (1966); made final, 33 Fed. Reg. 5848 (1968), 34 Fed. Reg. 933 (1969)).

In other instances, such as the issue of taxation of fringe benefits provided to employees, a very different type of Congressional action has resulted. In that area, this Court had held that the statutory provision defining "gross income" was broad enough to encompass "any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected." *Commissioner v. Smith*, 324 U.S. 177, 181 (1945). When the IRS promulgated proposed regulations to tax certain fringe benefits, however, Congress reacted with substantial concern. In 1978, Congress imposed a moratorium on any such regulations, Pub. L. No. 95-427, § 1, 92 Stat. 996 (1978) — one that has been extended successively through December 31, 1983. Pub. L. No. 96-167, § 1, 93 Stat. 1275 (1979); Pub. L. No. 97-34, § 807, 95 Stat. 172 (1981).

No one can predict with certainty which of these examples best illustrates the result which Congressional consideration of the issue now before the Court would engender. The reason is simple: the issue has never been presented by legislative proposal to Congress by the IRS or otherwise. But whatever the result, one can be confident that the outcome would be more comprehensive and flexible and more directly reflective of public will and Congressional tax policy than an *ad hoc* judicial decision. For these reasons, any claim by the IRS that interest-free demand loans are properly the subject of gift taxation should be directed to the governmental branch whose duty it is to fashion the tax law.

CONCLUSION

Neither the making of an interest-free demand loan nor the failure to demand repayment of such loan constitutes a taxable "transfer of property by gift." This had been the consistent interpretation of the gift tax law for some fifty years until the decision of the court below. A contrary holding will result in enormous administrative and judicial burdens and great unfairness to individual citizens. If interest-free demand loans are to give rise to gift taxation, it is the Congress which should mandate such a result.

Accordingly, the decision of the Court of Appeals should be reversed and the decision of the Tax Court affirmed.

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ESTHER C. DICKMAN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether intra-family interest-free loans, payable on demand or after a term, result in taxable gifts of the right to use money.

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In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1041

ESTHER C. DICKMAN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 690 F.2d 812. The opinion of the Tax Court (Pet. App. 15a-24a) is unofficially reported at 41 T.C.M. (CCH) 620.

JURISDICTION

The judgment of the court of appeals was entered on November 1, 1982. The petition was filed on December 17, 1982, and was granted on February 22, 1983. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

26 U.S.C. (1970 ed.) 2501(a)(1), as in effect during the periods here in issue,[1] provides:

> For the first calendar quarter of calendar year 1971 and each calendar quarter thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident.

26 U.S.C. (1970 ed.) 2511(a) provides in pertinent part:

> Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.

26 U.S.C. (1970 ed.) 2512(a) and (b), as in effect during the periods here in issue,[2] provided:

> (a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.
>
> (b) Where property is transferred for less than an adequate and full consideration in

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[1] In 1976, a non-substantive amendment was made to Section 2501(a)(1). See Tax Reform Act of 1976, Pub. L. No. 94-455, Section 1902(a)(10), 90 Stat. 1805; S. Rep. No. 94-938, 94th Cong., 2d Sess. 521 (1976). Effective for gifts made after December 31, 1981, the gift tax was made payable on a yearly basis. See Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 442(a)(1) and (e), 95 Stat. 320 and 323.

[2] The current version does not refer to "the calendar quarter." 26 U.S.C. (Supp. V) 2512(b); see note 1, *supra*.

money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar quarter.

STATEMENT

Paul and Esther C. Dickman were husband and wife until Paul's death in December, 1976 (Pet. App. 2a, 17a). For many years, beginning as early as 1963 (see JX 49-AW[3]), they made interest-free loans totalling hundreds of thousands of dollars to their child, Lyle C. Dickman (who died in May, 1976), and to a family-owned corporation, Artesian Farms, Inc. (Artesian) (Pet. App. 2a, 18a-19a).[4] The loans at issue here are those that were outstanding in the calendar years 1971 through 1976, ranging from totals of $370,846 to $569,046 for Lyle and from $276,526 to $738,384 for Artesian (Pet. App. 2a n.2). Substantially all the loans were evidenced by noninterest bearing demand notes.[5]

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[3] "JX" refers to the joint exhibits in the United States Tax Court. "Exh." refers to the exhibits attached to the petitions in the United States Tax Court.

[4] Artesian's stock was owned by Paul, Esther and Lyle Dickman, and by Lyle's wife and three children. Their proportionate shares are identified in the court of appeals' opinion (Pet. App. 2a n.1). The Commissioner treated gifts to Artesian as gifts to its shareholders in proportion to their stock interests, pursuant to Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2511-1(h)(1). See Exh. A.

[5] One $65,000 loan was made to Lyle on "open account" (without a written note); it was payable on demand. Another loan in the amount of $456,805.90, made to Artesian in March 1972, was evidenced by a ten-year note (Pet. App. 2a-3a, 19a-20a).

On audit, the Commissioner of Internal Revenue concluded that the loans were payable on demand and resulted in continuing gifts for the period during which the loans were outstanding in an amount equal to the value of the loans. The Commissioner determined that value by multiplying the loan balance outstanding at the end of each taxable quarter by the interest rates applicable under 26 U.S.C. (& Supp. V) 6601 and 6621 to tax underpayments for that quarter (Pet. App. 3a n.4, 21a).[6] On that basis, the Commissioner determined deficiencies in gift tax for all calendar quarters in the years 1971 through 1976. The deficiencies totalled $83,332.69 (Pet. App. 3a-4a, 21a).

Petitioners sought redetermination in the Tax Court of the gift tax deficiencies determined by the

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[6] These rates were as follows:

Periods	Interest Rate
Jan. 1, 1971-June 30, 1975	6%
July 1, 1975-Jan. 31, 1976	9%
Feb. 1, 1976-Dec. 31, 1976	7%

During these same periods, the prime rate ranged between 5.25% and 10.81%. See *Economic Report of the President*, H.R. Doc. No. 97-123, 97th Cong., 2d Sess., Table B-67 at 310 (1982) (hereinafter cited as H.R. Doc. No. 97-123).

Section 6601(a), as originally enacted, simply provided a straight 6% interest rate for underpayments. See Internal Revenue Code of 1954, ch. 736, Section 6601(a), 68A Stat. 817. In 1975, the 1954 Code was amended to provide a 9% rate, but subject to biennial adjustment to reflect changes in the "adjusted prime rate charged by banks." See Section 6621, as added by Section 7(a)(1), Act of Jan. 3, 1975, Pub. L. No. 93-625, 88 Stat. 2114. (Section 6621 now provides for semi-annual adjustment of the interest rate. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, Section 345(a), 96 Stat. 636.)

Commissioner.[7] The Tax Court held that none of the instant loans resulted in taxable gifts (Pet. App. 15a-24a), following its earlier holding in *Crown* v. *Commissioner*, 67 T.C. 1060 (1977) (reviewed by the court), nonacq., 1978-2 Cum. Bull. 3, aff'd, 585 F.2d 234 (7th Cir. 1978).

The court of appeals reversed (Pet. App. 1a-14a). Disagreeing with the Seventh Circuit's *Crown* decision, the court held that "interest-free loans are subject to the gift tax whether the loans are made for a fixed term or are on a demand basis" (Pet. App. 1a). The court found this conclusion "compelled by the gift tax statute as it is illuminated by its legislative history, established treasury regulations, judicial interpretation, and the policy considerations underlying it" (*id.* at 13a). The court of appeals accordingly remanded the case to the Tax Court to determine the amount of the taxable gifts (*id.* at 1a).[8]

SUMMARY OF ARGUMENT

Paul and Esther C. Dickman gave their son, Lyle, and his family (through their corporation, Artesian),

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[7] By amended answer, the Commissioner contended that the $456,805.90 loan (see note 5, *supra*) was a 10-year term loan, which resulted in a gift in the calendar quarter in which it was made equal to the difference between the amount lent and the fair market value of the term note given by Artesian (Pet. App. 20a, 21a). The Tax Court, however, found that the loan in question was in fact a demand loan (*id.* at 23a-24a).

[8] The court declined to decide whether the Tax Court had correctly found that the $456,805.90 loan was a demand loan, stating that the characterization of that loan related to the valuation issue, and "it is not absolutely clear at this point what difference the characterization will make since we hold that both term and demand loans produce taxable consequences" (Pet. App. 3a n.3).

the right to use, interest-free, hundreds of thousands of dollars for extended periods of time. The transfers of that right were transfers of "property," whether the rights conferred were to last for a predetermined time or were terminable at any time by the lenders. It is conceded that those transfers were made without consideration. Accordingly, although the loans themselves were not gifts, they were transactions whereby property was gratuitously transferred.

The federal gift tax covers any gratuitous transfer of any interest in property. This Court and the Commissioner's regulations have long recognized that the gift tax was designed to be all-inclusive. There is no reason to exclude from its reach the gratuitous donation of the valuable right to use money or any other property for substantial periods of time, whether that right is granted originally for a specific term or, as in a demand loan, is granted throughout the time it remains outstanding. Instead, including such gratuitous transfers effectuates the basic purpose of the gift tax, because it prevents taxpayers from avoiding income and estate taxes by the simple expedient of making large tax-free demand loans to their intended beneficiaries.

There is no significant distinction, for gift tax purposes, between low interest term loans, which have been recognized as giving rise to taxable gifts, and interest-free or low interest demand loans. Indeed, in the family context, such demand loans are properly viewed as indefinite term loans. While the valuation of such loans may be made only at the close of the period for which they have remained outstanding, this does not justify treating them differently than traditional term loans for gift tax purposes. The valuation of such loans involves simply the calculation

of the value of the right to use the money involved (as reflected in the appropriate interest rate) for the period the loan remains outstanding.

Whether interest-free loans result in taxable income to the recipient is an entirely separate question. While we disagree with cases refusing to recognize such income on the ground that if the borrower were required to pay interest that interest would be a deductible expense, that rationale is inapplicable in the gift tax context. Finally, treating the gratuitous donation of the right to use money or other property for extended periods of time as within the purview of the gift tax will cause neither administrative problems nor anomalies in the application of the tax laws. Because of the substantial exemptions and exclusions from the gift tax, ordinary loans between family members, like the usual intra-family gifts, simply do not create gift tax liability.

ARGUMENT

I. THE GIFT TAX REACHES ANY GRATUITOUS TRANSFER OF ANY INTEREST IN PROPERTY

A. The Statute And The Regulations

The statutory language of the federal gift tax establishes that it reaches any gratuitous transfer of any interest in property. Section 2501(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. (Supp. V)) imposes a gift tax on any "transfer of property by gift" made by an individual during the taxable quarter. Section 2511(a) (26 U.S.C.) provides that "the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift

is direct or indirect, and whether the property is real or personal, tangible or intangible." [9]

The Committee reports accompanying the Revenue Act of 1932, ch. 209, Sections 501-507, 47 Stat. 245-249, in which the present federal gift tax was enacted,[10] emphasize Congress's specific intent to reach all gratuitous transfers of any type of interest in property:

> The terms "property," "transfer," "gift," and "indirectly" are used in the broadest and most comprehensive sense; the term "property" reaching every species of right or interest protected by law and having an exchangeable value.
>
> The words "transfer * * * by gift" and "whether * * * direct or indirect" are designed to cover and comprehend all transactions (subject to certain express conditions and limitations) whereby and to the extent * * * that property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment.

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[9] Section 2512(b) (26 U.S.C. (Supp. V)) makes clear that the taxable "transfer of property by gift" (26 U.S.C. (Supp. V) 2501(a)(1)) includes situations in which the fair market value of property transferred exceeds the consideration received in a bargain sale or other unequal exchange.

[10] In 1924, Congress had enacted an earlier gift tax, Revenue Act of 1924, ch. 234, Sections 319-324, 43 Stat. 313-316, which was repealed two years later by Section 1200 of the Revenue Act of 1926, ch. 27, 44 Stat. 125. The 1924 gift tax was computed annually without taking into account the donor's previous gifts; there was an exemption for $50,000 in gifts each year. C. Lowndes, R. Kramer & J. McCord, *Federal Estate and Gift Taxes* § 22.1, at 639-640 (3d ed. 1974); Harriss, *Legislative History of Federal Gift Taxation*, 19 Taxes 531 (1940).

H.R. Rep. No. 708, 72d Cong., 1st Sess. 27-28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).[11]

In light of these clear indications of Congress's intent that the gift tax was to be comprehensive, "there is little need to specifically enumerate interest-free loans as a taxable gift or as included in the term 'all transactions.'" *Crown* v. *Commissioner*, *supra*, 585

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[11] The *Crown* court concluded (585 F.2d at 239) that the borrower who received an interest-free demand loan had neither an interest "protected by law" nor one with "an exchangeable value." But the fact that the borrower must repay the loan when the lender demands it surely does not mean he has no legally protectable interest at all. "At will" interests are property, legally enforceable against third parties (pages 17-19, *infra*); and, of course, the borrower's rights to the earnings on the funds lent that accrue while he holds them are legally enforceable against all persons, including the lender. Moreover, the property interests here—the right to use money—clearly have an exchangeable value. Unlike an "at will" interest in real property, where the tenant's attempted transfer could terminate his estate (*Restatement (Second) of Property of Landlord & Tenant* § 1.6 comment d (1977)), it is evident that recipients of cash loans have the right to use the money in the only way it has utility—by transferring it for value received. Even if the lender restricts the uses for which the loans may be spent (and there is no evidence that any such restrictions were imposed here) that does not deprive the property interest the borrower received of all "exchangeable value." For example, if a taxpayer lends his son $100,000 for the son to use to purchase stock, the son has received property having exchangeable value, even if the terms of the loan provide that the son must use the loan only to purchase a particular stock. Indeed, any other rule would provide a simple mechanism for avoiding the gift tax on interest-free loans. Many loans of personal property contemplate consumption or transfer of the property lent, ranging from the neighbor's loan of a cup of sugar to the broker's loan of securities to effectuate a short sale. Cf. *Deputy* v. *Du Pont*, 308 U.S. 488 (1940).

F.2d at 242 (Van Pelt, J., dissenting). Indeed, as observed by Randolph Paul:

> The very breadth of the gift concept renders it impossible to make a complete enumeration of the types of transfers subject to tax. Moreover, any specific enumeration would be unwise from the revenue standpoint. To define is to limit, and the purpose of Congress was undoubtedly to exert its taxing power to a sweeping extent.

2 R. Paul, *Federal Estate and Gift Taxation* § 16.03, at 1069 (1942) (footnotes omitted).[12]

This Court on several occasions has recognized that the gift tax was intended to be all-inclusive.[13] Thus, in *Commissioner* v. *Wemyss*, 324 U.S. 303, 306 (1945), the Court explained that "Congress intended

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[12] Amicus Jones, Day is thus wrong in asserting (Br. 4, 10-12) that the gift tax statute is ambiguous and should not be applied to the instant transfers absent "specific congressional authority." But even if the statute were ambiguous, it would be appropriate for the Commissioner and the courts to resolve that ambiguity. Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 Harv. L. Rev. 84, 90 (1951) ("We have had enough experience with the tax laws to know that Congress cannot do everything, and that it is ordinarily a mistake to expect that Congress will formulate precise rules to cover every refinement and detail of human experience so far as its tax results are concerned. Many of the interstices must, of necessity, be filled in by the courts and by administrative action.").

[13] *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943) ("[t]he language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent"); *Robinette* v. *Helvering*, 318 U.S. 184, 187 (1943) (purpose of the gift tax is to "reach every kind and type of transfer by gift"); *Jewett* v. *Commissioner*, 455 U.S. 305, 310 (1982) (gift tax is to be given "expansive reading").

to use the term 'gifts' in its broadest and most comprehensive sense," and noted "the evident desire of Congress to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech." The Court concluded that Congress had adopted a "workable external test" under which there is a gift whenever there is a transfer of property by an individual, not in the regular course of business, for less than adequate and full consideration. *Id.* at 306-307.[14] In its sweep the gift tax is thus comparable to the income tax, where Congress exerted " 'the full measure of its taxing power.' " *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955), quoting *Helvering* v. *Clifford*, 309 U.S. 331, 334 (1940).

The Treasury regulations have always reflected the broad sweep of the statutory language. Thus, the

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[14] This interpretation refutes petitioners' claim (Br. 19) that the words "transfer of property by gift" must be read "literally and in accordance with their ordinary, everyday meaning" and that "whatever the borrower may have in a demand loan situation, it is not 'property' as that term is ordinarily used" (*id.* at 22-23). That claim is also inconsistent with *Boston & Lowell R.R.* v. *Salem & Lowell R.R.*, 68 Mass. (2 Gray) 1, 35 (1855) ("property is *nomen generalissimum*, and extends to every species of valuable right and interest"). Petitioners seek support in cases interpreting the common-law definition of the term "gift" (Br. 10 n.6). Those cases, however, have no relevance here since "common law considerations were not embodied in the gift tax." *Wemyss*, *supra*, 324 U.S. at 306 (footnote omitted). Nor is it relevant that gifts of services may not give rise to taxable gifts (Pet. Br. 25). See, *e.g.*, Rev. Rul. 66-167, 1966-1 Cum. Bull. 20. A gift of services simply does not involve a transfer of "property." But cf. Rev. Rul. 64-225, 1964-2 Cum. Bull. 15 (waiver of vested right to receive payment for services effects taxable gift).

original regulations issued under the Revenue Act of 1932 provided:

> [A]ll transactions whereby property or property rights or interests are donatively passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

Treas. Reg. 79, Art. 2 (1933); Treas. Reg. 79, Art. 2 (1936).[15] This language has appeared (with the single substitution of the word "gratuitously" for "donatively") in all subsequent gift tax regulations, including the current ones. See Treas. Reg. 108, § 86.2(a) (1943); Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2511-1(c).[16]

The regulations also have long recognized that taxable gifts may result where the donor retains an interest in the property transferred, as when he makes a term or demand loan. Section 25.2511-2(c) (26 C.F.R.) provides that a transfer of a term estate results in a taxable gift equal to the value of that estate. A term loan is not different in any relevant respect from a term estate in property. And, significantly, the regulations have since 1936[17] stated

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[15] Treasury regulations promulgated under the prior gift tax similarly provided that "[t]he subject of the gift may consist of any species of property or interest therein, whether legal or equitable." See Treas. Reg. 67, Art. 1 (1924).

[16] See also 26 C.F.R. 25.2512-8, providing that:

> Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor.

[17] See Treas. Reg. 79, Art. 3 (1936).

that in the case of a transfer of property which is not a taxable gift of that property because the transferor retains power over the disposition of the property, any "receipt of income or of other enjoyment of the transferred property by the transferee" during the period before the gift is complete "constitutes a gift of such income or of such other enjoyment taxable as of the calendar quarter * * * of its receipt." 26 C.F.R. 25.2511-2(f). The loans to Lyle and Artesian were not gifts of the sums transferred because they agreed to repay those amounts upon demand. However, since they received the right to use that money (and thus the right to retain all earnings attributable to that money) in the taxable periods involved, they received the beneficial enjoyment of that transferred property, which under 26 C.F.R. 25.2511-2(f) constitutes a taxable gift to the extent of the value of that right.

Petitioners (Br. 12) and the Seventh Circuit in *Crown*, *supra*, 585 F.2d at 241, are accordingly incorrect in asserting that the Commissioner's view that interest-free demand loans result in taxable gifts is a recent departure from established administrative interpretations. See also pages 22-33, *infra*.[18] Despite

[18] Similarly, Amicus Jones, Day's assertion (Br. 6-10) that the courts' rejection of the government's views in *Johnson* v. *United States*, 245 F. Supp. 73 (N.D. Tex. 1966), and *Dean* v. *Commissioner*, 35 T.C. 1083 (1961), non acq., 1973-1 Cum. Bull. 4, reflected a judicial unwillingness to adopt a novel administrative interpretation is hardly in accord with contemporary statements by legal commentators. See, *e.g.*, Wilkes, *Tax Court Holds Interest-Free Loans to Shareholder Creates No Taxable Income*, 14 J. Tax'n 351, 351 (1961) (*Dean* decision represents "a bold step into a new and interesting area"); Benefied, *Gross Income—Interest-Free Loans*, 13 Mercer L. Rev. 421, 424 (1962) ("Is this [*Dean*] the beginning of a new

the fact that the first case to be litigated involving the gift taxation of interest-free demand loans (*Johnson* v. *United States*, 254 F. Supp. 73 (N.D. Tex. 1966)) was decided less than 20 years ago,[19] and the Commissioner did not issue a ruling on the subject until 1973,[20] it was nevertheless reasonably clear from

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trend in taxing policy or is the exclusion of this benefit from gross income just a mistake?"); Westover, *Gift Taxation of Interest-Free Loans*, 19 Stan. L. Rev. 870 (1967); Note, *The Value of the Use of Money Loaned by Taxpayers to Their Children Without Interest Does Not Constitute a Gift*, 5 Hous. L. Rev. 138, 141-142 (1967) ("an examination of the law and the facts clearly shows the lack of justification for this decision [*Johnson*, *supra*]"). See also pages 29-33, *infra*, (distinguishing *Dean*).

[19] The lack of earlier cases may well be due to the fact that interest rates, until fairly recently, have been relatively low. H.R. Doc. No. 97-123, *supra*, Table B-67, at 310 (from 1933 to 1960, the prime interest rate ranged between 1.5% and 4.82%). At such low interest rates, taxpayers could lend large sums without exceeding the per donee exclusion and lifetime exemption. See pages 34-36, *infra*. In addition, although as petitioners assert (Br. 9), "[i]n 1932, as today, interest-free demand loans within families were common features of American life," it appears that the use of interest-free loans by wealthy taxpayers of sufficient amount to generate gift tax liability has increased greatly in frequency in recent years. See, *e.g.*, Am. Br. D'Ancona & Pflaum 5. See also the articles advocating the use of interest-free loans, page 20 note 26, *infra*.

[20] There are myriad transactions that may have tax consequences. It is obviously impossible to publish a ruling as to each such transaction or type of transaction and the failure to do so is not an announcement that such transactions are outside the tax law. See *Helvering* v. *Hallock*, 309 U.S. 106, 120-121 (1940) ("inaction by the Treasury can hardly operate as a controlling administrative practice, through acquiesence, tantamount to an estoppel").

earlier regulations that the gift tax does reach the value conferred by interest-free demand loans.[21]

B. Application To Interest-Free Loans

Paul and Esther C. Dickman gave their son, Lyle, and his family the right to use, interest-free, hundreds of thousands of dollars for many years. Under the broad statutory language as interpreted by this Court and longstanding treasury regulations, these loans clearly resulted in taxable gratuitous transfers of property. This result follows, as the Court below recognized, for all the loans, whether they were payable after a predetermined set period (see notes 5, 7, 8, *supra*), or were payable on demand.

The right to use property for a predetermined definite period of time is itself "property," whether the underlying property is real estate, money or other

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[21] Even if the Commissioner had made an administrative interpretation that interest-free loans do not result in taxable gifts, it is well settled that the Commissioner may change that interpretation, if incorrect, and may even do so retroactively. See *Dixon* v. *United States*, 381 U.S. 68, 72-73 (1965); *Automobile Club* v. *Commissioner*, 353 U.S. 180, 183-184 (1957); *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 101 (1939); *Wisconsin Nipple and Fabricating Corp.* v. *Commissioner*, 581 F.2d 1235 (7th Cir. 1978). Several of the loans here were, in any event, made after the issuance of the 1973 Revenue Ruling (Pet. App. 2a-3a n.2, 19a).

There is no merit to the argument of amicus Jones, Day (Br. 13 n.18) that the mere reenactment or amendment of a tax statute freezes the scope of the statute in the contours of administrative interpretations previously made. See Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 398, 399 n.7, 400 (1941) (*"the mere reenactment of a statute following administrative construction should be given no weight whatever in determining the proper construction of the statute"*); cf. *Helvering* v. *Hallock*, *supra*, 309 U.S. at 119-120.

property. *Threlfall* v. *United States*, 302 F. Supp. 1114, 1117-1118 (W.D. Wis. 1969) (term leasehold is property); *Allen* v. *Commissioner*, 57 T.C. 12 (1971) (same).[22] The same result follows where the right to use property is not for a definite predetermined period, but is to last for some indefinite period. See Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2512-5(c) (right to use property for the life of another person is property); *Abbott* v. *United States*, 74-2 U.S. Tax Cas. (CCH) ¶ 13,040 (S.D. Miss. 1974) (same); *Sullivan* v. *Commissioner*, 16 T.C. 228, 231 (1951), acq., 1951-1 Cum. Bull. 3 (right to use property for duration of war is property); *Thriftimart, Inc.* v. *Commissioner*, 59 T.C. 598, 615-616 (1973), acq., 1973-2 Cum. Bull. 4, remanded on other issues, No. 73-3108 (9th Cir. Dec. 10, 1975) (lease terminable by owner on sale of building is property). Indeed, petitioners (Br. 20-23, 29 n.23) apparently do not contest these evident principles (see also Am. Br. Jones, Day 17 n.23).[23]

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[22] As the court explained in *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1963):

> "Property" is more than just the physical thing—the land, the bricks, the mortar—it is also the sum of all the rights and powers incident to ownership of the physical thing. It is the tangible and intangible. Property is composed of constituent elements and of these elements the right to *use* the physical thing to the exclusion of others is the most essential and beneficial. Without this right all other elements would be of little value, for if the owner is deprived of the use of the tangible thing, little more than a barren title is left in his hand.

[23] Amicus Jones, Day does attempt to distinguish the cited cases on the ground that they "involved charitable deductions, and the operative statute in each required only a 'contribution,' not a 'transfer of property by gift' " (Br. 17 n.23). However,

It is equally clear that the right to use property for an indefinite period, terminable at any time by the property's owner, also is "property." Rev. Rul. 73-61, 1973-1 Cum. Bull. 408; *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1983). Indeed, it is, for example, blackletter law that a tenancy at will in real property is an "estate," *i.e.*, a property interest. See *Restatement of the Law of Property* §§ 9, 21 (1936); *Covina Manor, Inc.* v. *Hatch*, 133 Cal. App. 2d Supp. 790, 792-793, 284 P.2d 580, 582 (App. Dep't Super. Ct. 1955); *Public Service Co.* v. *Voudomas*, 84 N.H. 387, 388-390, 151 A. 81, 83-84 (1930); 2 R. Powell, *The Law of Real Property* ¶ 256 (1977); 1 H. Tiffany, *The Law of Real Property* ¶ 155 (3d ed. 1939). As the Fourth Circuit observed in *United States* v. *Smoot Sand & Gravel Corp.*, 248 F.2d 822, 827 (1957) (footnote omitted):

> It cannot be disputed that when one is assigned the right, pending its revocation, to use or consume something to the exclusion of all others, and to receive compensation from anyone who ven-

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although Section 170(a)(1) of the 1954 Code relating to charitable deductions does not specifically use the word, it is understood that it requires a transfer of "property". See, *e.g.*, *Orr* v. *United States*, 343 F.2d 553, 555 (5th Cir. 1965) (" 'The Code contemplates a contribution of money or property'[.] * * * [citing] 5 J. Mertens, The Law of Federal Income Taxation § 31.05, 35." See also 26 C.F.R. 1.170A-1(c)(1). Indeed, a well-recognized line is drawn between the nondeductible rendering to charity of a personal service and the deductible contribution of "property." See 1 S. Surrey, W. Warren, P. McDaniel & H. Ault, *Federal Income Taxation: Cases and Materials* 580 (1972). Moreover, regardless of whether Section 170 requires a transfer of "property" in all instances, amicus ignores the fact that several of the cases in question specifically decided that the interests transferred constituted "property." See, *e.g.*, *Thriftimart, Inc.*, *supra*, 59 T.C. at 615

> tures to exercise the privilege without his authority, he has a species of property, regardless of what theory of property we may adopt.

The economic realities of the instant transactions lead to the same conclusion that a gratuitous transfer of property has occurred. By making interest-free loans to Lyle and Artesian, the Dickmans effectively transferred to them the valuable economic control over hundreds of thousands of dollars.[24] As this Court has recognized, albeit in a different context, the making of an interest-free loan results in the transfer of a valuable economic right:

> It is virtually self-evident that extending interest-free credit for a period of time is equivalent to giving a discount equal to the value of the use of the purchase price for that period of time.

Catalano, Inc. v. *Target Sales, Inc.*, 446 U.S. 643, 648 (1980). See also *Martin* v. *Commissioner*, 649 F.2d 1133, 1136 (5th Cir. 1981) (Goldberg, J., dissenting):

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[24] Moreover, as observed by Tax Court Judge Simpson in his dissent in *Crown, supra*, had the taxpayers there "arranged for the borrowers to obtain the money from financial institutions and agreed to pay the interest thereon, clearly, the payment of such interest would constitute a taxable gift" (67 T.C. at 1066). Where taxpayers achieve precisely the same economic result by lending the money directly, we submit that there is no justification for a different tax treatment. Indeed, the instant transaction is also similar in economic substance to the situation where the donor retains funds in an interest-bearing account but transfers to the donee the right to receive the interest payments for an indefinite period—obviously a taxable gift. Surely the transfers here are no less taxable gifts merely because the donees had additional options in the use of the money besides depositing it in an interest-bearing account and keeping the proceeds.

The use of money—the opportunity to make additional income or to spend today and pay tomorrow—is a valuable right, which individuals must usually pay for by securing interest-bearing loans. Interest is a form of "rent" for the use of money.

II. THE HOLDING BELOW EFFECTUATES THE CONGRESSIONAL POLICY UNDERLYING THE GIFT TAX STATUTE

The gift tax was specifically designed to supplement both the income tax and the estate tax, by taxing inter-vivos gifts and thereby preventing taxpayers from reducing their yearly incomes as well as their gross estates through tax-free gifts to close family members and others. H.R. Rep. No. 708, 72d Cong., 1st Sess. 28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 40 (1932). See also 65 Cong. Rec. 8095-8096 (1924); *Harris* v. *Commissioner*, 340 U.S. 106, 107 (1950); *Smith* v. *Shaughnessy*, 318 U.S. 176, 179 & n.1 (1943); *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44 (1939).[25] Here, Paul and Esther C. Dickman shifted to Lyle and Artesian the income that would be generated by the money lent them, thereby reducing their own income taxes and ultimately the amounts of their taxable estates.

If interest-free demand loans are not subject to gift taxes, the potential loss of tax revenues may be

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[25] As the Seventh Circuit in *Crown* acknowledged (585 F.2d at 236; footnote omitted):

> The concern here is that people will use gifts of income producing property to split up an income taxable in a high tax bracket into smaller incomes taxable in lower brackets. No-interest loans do just that. Moreover, where the loans are payable on demand, the maker of the loans is able to achieve this result without the inconvenience of losing access to the principal should the need arise.

quite substantial in light of the fact that tax practitioners and financial advisers have recognized and widely advocated the use of such loans as a device to split incomes and reduce estate taxes. Am. Br. D'Ancona & Pflaum 5; Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 Colum. L. Rev. 161, 186 (1977).[26] In the *Crown* case alone, the taxpayers successfully transferred tax free each year property worth more than $1 million to their children and other close relatives (585 F.2d at 235).[27]

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[26] See, *e.g.*, Bettner, *Interest-Free Loan to Poorer Relations Can Cut Income Taxes if He Invests Money in His Name*, Wall St. J., Dec. 20, 1982, at 42, col. 1; Thater & Richey, *An Overview of Cases Dealing with Interest-Free Loans*, 121 Tr. & Est. 35 (Dec. 1982); Note, *Interest-Free Loans: Opportunities for Tax Planning*, 65 A.B.A. J. 634, 636 (1979); Edwards, *What Planning Opportunities Does CA-7's No-Gift—Tax Holding in Crown Open Up?*, 50 J. Tax'n 168, 170 (1979); Aslanides & McGowan, *Interest-Free Loans Get Green Light as Compensation and Estate Planning Devices*, 21 Tax. Acct. 260, 264-265 (1978); Taicher, *How to Use Interest-Free Loans in Family Tax Planning*, 11 Prac. Acct. 24, 27-28 (Sept. 1978); Tidwell, *Lester Crown Points the Way to Estate Tax Reduction Under the 1976 Tax Reform Act*, 55 Taxes 651 (1977); Burke, *Interest-Free Loans—A Valuable Family Tax Planning Tool?*, 48 Taxes 137 (1970); Seidman & Stuetzer, *Tax Clinic*, 120 J. Acct. 75 (1965).

[27] Although the *Crown* court recognized that imposing a gift tax on interest-free loans would protect the income tax (see note 25, *supra*), it did not agree that the estate tax would also be protected. The Seventh Circuit reasoned that, had the taxpayer not made the loans, he would be under no duty to invest that money, and consequently the loans could only reduce his *potential* estate (*i.e.*, the interest he might have earned), rather than his actual estate (since the full principal amount of the loans would, the court reasoned, be included in his estate). The court denied "that the congressional purpose

In addition, a holding that the instant loans do not result in taxable gifts would substantially undercut the grantor trust income tax provisions. If the settlor of a trust retains significant rights in or powers over the corpus of the trust, the 1954 Code treats him as the owner of the trust and he is taxable on any

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of protecting the estate tax was concerned with the use of gifts to diminish a taxpayer's potential estate as well as his actual one" (585 F.2d at 237). See also *Crown*, *supra*, 67 T.C. at 1063-1064; *Johnson*, *supra*, 254 F. Supp. at 77. But Congress clearly *was* concerned with transactions that would reduce potential estate taxes (H.R. Rep. No. 708, *supra*, at 28; S. Rep. No. 665, *supra*, at 40; 65 Cong. Rec. 3119-3120 (1924) (purpose of statute is "to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death")). Just as a gratuitous transfer of income-producing property enables the taxpayer to escape income tax liability on the future income that property would generate, such a transfer also enables the taxpayer to avoid the future estate tax liability that would result from the earnings generated by that property which would ultimately become part of his estate.

In any event, the Seventh Circuit was wrong in its assumption that making an interest-free demand loan does not reduce a taxpayer's "actual" estate. In fact, it probably will do so, since any outstanding notes will be worth less than face value. The right to receive repayment of a loan is worth less than the face amount of the loan. No one would pay $1,000 for the right to demand payment from another person of $1,000; there would have to be some discount for the delay, however short, in repayment, as well as for the risk of noncollectibility. Although that discount might be very little, it could also be substantial where the borrower's ability to repay was in great doubt. See Rev. Rul. 81-286, 1981-2 Cum. Bull. 177, 178.

Finally, even if it were assumed that protection of the estate tax is not furthered by taxing interest-free loans, the protection of the income tax alone would be sufficient to justify application of the gift tax to such loans.

income earned by the trust. See 26 U.S.C. 671. See also *Helvering* v. *Clifford*, 309 U.S. 331 (1940). In order to avoid taxability on a trust's income, the settlor must create a trust of at least 10 years' duration (26 U.S.C. 673), and must comply with the other safeguards against retained powers or interests contained in 26 U.S.C. 674-677. These safeguards would be unavailing if a taxpayer could, without gift tax liability, avoid the trust requirements merely by making a demand loan to the desired beneficiary. The taxpayer could then call the loan at any time, while the beneficiary could meanwhile invest the funds in income-producing assets, on which income he, not the lender, would be taxed.

III. THE HOLDING BELOW IS CONSISTENT WITH DECISIONAL LAW CONCERNING RELATED SITUATIONS

A. Term Loans

The Tax Court has recognized that a taxpayer who makes a term loan at below market interest rates confers a taxable gift equal to the difference between the amount lent and the fair market value of the promissory note received in exchange.[28] *Berkman* v. *Commissioner*, 38 T.C.M. (CCH) 183, 186 (1979); cf. *Blackburn* v. *Commissioner*, 20 T.C. 204 (1953) (sale of property for low interest promissory note results in taxable gift in amount of discount). Indeed, the Seventh Circuit has itself recognized the same principle, holding in *Mason* v. *United States*, 513 F.2d 25

[28] Because a term note bearing a below market interest rate has a market value of less than its face amount, a loan evidenced by a note for the amount borrowed at a below market interest rate does not represent an equal exchange of value, and accordingly results in a gift taxable under the Internal Revenue Code of 1954, 26 U.S.C. (Supp. V) 2512(b).

(1975), that such a transfer gives rise to a deduction for a charitable contribution.

Precisely the same principles apply when the loan is not for a set term and the interest rate is reduced to nothing. In the case of a below market, or interest-free, term loan, there is an immediate gift of the right to use the money for the predetermined period, whereas in the demand loan situation there is an on-going gift of the right to use the money for as long as the lender allows.[29] But this difference relates only

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[29] Petitioners contend that this view of a demand loan "is at war with the ordinary concept of the term 'transfer,' " which in their view "connotes a discrete, affirmative act whereby a person conveys something to another person, not a continuous series of minute failures to require return of something loaned" (Br. 22). Petitioners also point (*id.* at 20, 22) to the reference in 26 U.S.C. 2512(a) to "the date of the gift." Petitioners ignore the fact that there undeniably is a transfer of property in these situations. Moreover, the regulations specifically contemplate gifts occurring over a period of time. See 26 C.F.R. 25.2511-2(f) (where there is an incomplete gift in trust, receipt by the beneficiary of the enjoyment of the transfered property "constitutes a gift * * * as of the calendar quarter or calendar year of its receipt"). In sum, when borrowers like Lyle and Artesian are given, for a period of several years, the right to use hundreds of thousands of dollars, they have received a gift. The fact that this gift is accomplished by the failure to call for repayment of demand loans, instead of by some other method (such as a term loan or gift of money to pay interest to a bank) can make no difference in light of Congress's express intent that the gift tax "cover and comprehend all transactions * * * whereby * * * property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment" (H.R. Rep. No. 708, *supra*, at 27-28; S. Rep. No. 665, *supra*, at 39).

The *Crown* court acknowledged that the gift could be viewed as "occurring continuously during the period that the loan is

to the valuation of the gift; it does not justify disparate tax treatment of the gift itself.[30]

Indeed, any distinction between term and demand loans in close family situations such as the present

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outstanding" (585 F.2d at 240); it nevertheless concluded that (*ibid.*; footnote omitted)—

> To characterize the mere use of property as a transfer of a property right implies a broader concept of what constitutes a property right under the gift tax laws than has heretofore been recognized.

The court, however, failed to recognize that the transfer before it was not simply of the use of the money, but rather a transfer of the right to use the money. The right to use property (including money) "on demand" clearly is itself "property," the value of which depends on the length of time the donee is given that right (see pages 17-19, *supra*).

[30] The conclusion that interest-free loans, whether term or demand, result in taxable gifts has received strong support from the commentators. See, *e.g.*, S. Surrey, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation: Cases and Materials* 154-156 (2d ed. 1982); R. Stephens, G. Maxfield, S. Lind & D. Calfee, *Federal Estate and Gift Taxation* ¶ 10.01[2][f] (5th ed. 1983); H. Dubroff & D. Kahn, *Federal Taxation of Estates, Gifts and Trusts* ¶ 20-02, at 314 (3d ed. 1980); Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459, 468-469, 489-490 (1980); Pulliam, *Income and Gift Tax Implications of Nonbusiness Interest-Free Loans: Looking a Gift Horse in the Mouth*, 58 Taxes 675 (1980); Carey, *Interest-Free Loans and the Gift Tax: Crown v. Commissioner*, 38 Ohio St. L.J. 903, 907-916 (1977); O'Hare, *The Taxation of Interest-Free Loans*, 27 Vand. L. Rev. 1085, 1088 (1974); *Recent Development—Gift Taxes—Interest-Free Demand Loans Are Not Taxable Gifts—Johnson v. United States*, 65 Mich. L. Rev. 1014 (1967); Westover, *Gift Taxation of Interest-Free Loans*, 19 Stan. L. Rev. 870 (1967); Note, *The Value of the Use of Money Loaned by Taxpayers to their Children Without Interest Does Not Constitute a Gift*, 5 Hous. L. Rev. 138 (1967).

case is largely artificial; demand loans made in such circumstances are not necessarily comparable to arm's-length demand loans, and may have characteristics resembling outright gifts of money. For example, where a bank makes a demand loan, it might be expected to demand repayment if the borrower's financial position deteriorates. In contrast, when a father makes a demand loan to his child and the child's financial position worsens, the father is *less* likely to demand repayment. Indeed, the father might even forgive the loan or make additional loans.[31] In family situations demand for repayment would thus generally be made, not when an unrelated creditor might do so, but rather at such time as the borrower has sufficient funds to repay the loan. In fact, the testimony as to the loans to Artesian was precisely to this effect (Tr. 23), and the Tax Court found that demand for repayment would be made "when it was financially beneficial [to Artesian] to do so" (Pet. App. 23a).[32]

The reality of such demand loans is accordingly that they are typically made with the intent that repayment will be made only when the debtor has suffi-

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[31] Compare the limitation on the deduction of nonbusiness bad debts contained in 26 U.S.C. (& Supp. V) 166(d), which was enacted to curb abuses where taxpayers claimed bad debt deductions on intra-family "loans" where there was in fact no expectation of repayment. See H.R. Rep. No. 2333, 77th Cong., 2d Sess. 45 (1942). See also *Putnam* v. *Commissioner*, 352 U.S. 82, 91 (1956).

[32] Compare the following finding in *Johnson*, *supra*, 254 F. Supp. at 76, involving intra-family interest-free demand loans made over an eight-year period:

> No demand was made by taxpayers of the debtors for repayment, and the repayments as reflected by the [stipulated] facts were voluntary rather than forced payments.

cient funds available, if in fact there is any intent to seek repayment at all. Thus, these loans are usually made for indefinite, extended periods.[33] Indeed, here

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[33] If the parties to a demand loan do not in fact contemplate that the borrower will have the use of the money for an extended period of time, then a gift of the entire principal amount of the loan may result if demand for repayment is not made within a few years of the date of the loan. See *Estate of Lang* v. *Commissioner*, 613 F.2d 770, 772-774 (9th Cir. 1980) (taxable gift occurred where mother permitted three-year statute of limitations to expire on interest-free demand notes); Rev. Rul. 81-264, 1981-2 Cum. Bull. 186. In many jurisdictions the statute of limitations for bringing suit on a demand note begins to run from the date of the note. See, *e.g.*, *Estate of Lang*, *supra*, (State of Washington); *Schnug* v. *Schnug*, 203 Kan. 380, 454 P.2d 474 (1969); U.C.C. § 3-122(1)(a). However, "where an agreement for payment of money contemplates an indefinite delay in payment, the statute of limitations does not begin to run until the actual demand has been made." *Cochran* v. *Cochran*, 133 Wash. 415, 419, 233 P. 918, 920 (1925). See also *Barer* v. *Goldberg*, 20 Wash. App. 472, 475, 582 P.2d 868, 871 (1978); *Vermilyea* v. *Vermilyea*, 61 Cal. App. 608, 215 P. 686 (1923). Florida law, which presumably would govern the instant loans, currently provides that the statute of limitations on demand notes begins to run only upon written demand for payment. Fla. Stat. Ann. § 95.281 (West. 1982) (formerly § 95.031(1)); Fla. Stat. Ann. § 673.3-122(2) (West 1966 & Cum. Supp. 1983). See *Ruhl* v. *Perry*, 390 So. 2d 353, 356 (Fla. 1980). Thus, since demand for payment was not made on the loans to Lyle represented by notes, it would appear that the statute of limitations for suit on those notes did not begin to run during the periods involved here. See *Ruhl* v. *Perry*, *supra*. On the other hand, the $65,000 loan to Lyle made on open account on June 30, 1975 (Stip. of Facts ¶ 12) may have resulted in a taxable gift in its principal amount if it were still outstanding when the four-year statute of limitations for suit on oral contracts expired after the taxable periods here in issue. Fla. Stat. Ann. § 95.11(k) (West 1982). See *Stoudenmire* v. *Florida Loan Co.*, 117 So. 2d 500 (Fla. Dist. Ct. App. 1960).

the $144,715.87 lent Lyle by Paul in 1963 and the $166,130.05 lent Lyle by Esther in 1964 remained outstanding through the end of 1976 (see JX 49-AW). Such "demand" loans thus are more accurately characterized as indefinite term loans.

It is true that the timing of the gift, and thus its valuation, is different when a demand loan rather than a term loan is involved. But the valuation of the gift that occurs over the period when a demand loan is outstanding presents no serious difficulties.[34] In the case of a term loan, the borrower is granted the right to use the money for a predetermined period, and therefore there is an immediate gift of the fair market value of that right. In contrast, where a lender makes a demand loan, he makes a continuing transfer of the right to use property until such time as he demands its repayment. Thus, a demand loan results in an ongoing gift equal in amount to the fair market value of the right to use the money lent for the taxable periods during which the lender permits the borrower to use the money. Rev. Rul. 73-61, *supra*.

The Treasury Regulations provide that the value of property for gift tax purposes is "the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having rea-

[34] The *Crown* court believed "the imputation of interest in subsequent time periods is seriously deficient as a measure of * * * value as of the time of the loan" (585 F.2d at 239). But this erroneously assumes that the entire gift took place the instant the loan was made. In fact, the gift is the ongoing right to use the money transferred for the period during which the lender refrains from demanding repayment, and therefore the correct method of valuing the transfer is by reference to the taxable periods during which the loan remains outstanding.

sonable knowledge of relevant facts." 26 C.F.R. 25.2512-1. In determining the value of a demand or term loan, one must first determine what interest rate would be charged on a comparable loan in an arm's length transaction.[35] The amount of the gift resulting then can readily be determined by accepted valuation methods, using a table set forth in the Gift Tax Regulations. Assuming a 10-year, interest-free term loan of $100,000 and assuming that an appropriate arm's length interest rate for such a loan would be 6%, the value of the loan would be equal to the present discounted value of the right to receive 6% interest on $100,000 for a period of ten years. Under 26 C.F.R. 25.2512-9(f), Table B, col. 3, this would be equal to $100,000 x .441605, or $44,160.50.[36] In contrast, the amount of the gift resulting from an interest-free

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[35] The Commissioner here determined the proper interest rate by reference to certain rates prescribed by statute, which are tied to the prime rate. See note 6, *supra*. Those rates were not shown by petitioners to be excessive. Indeed, the rates selected probably underestimated the rates that would have been charged in an arm's length transaction, since it is unlikely that Lyle and Artesian could have borrowed at the prime rate. In any event, it was incumbent on petitioners, if they disagreed with the posited rates, to come forward with proof of more appropriate rates. Although petitioners and Amici urge that the Commissioner has proposed different rates of interest in different cases, none of these cases has ever reached the valuation stage. We note also that the prime rate has varied substantially over the periods involved in the cases. See H.R. Doc. No. 97-123, *supra*, Table B-67, at 310.

[36] This amount also is equal to the difference between the amount transferred ($100,000) and the value of the term note which the lender receives in exchange. That note, which represents the right to receive $100,000 in 10 years but without interest, has a present discounted value (assuming an appropriate interest rate for interest-bearing notes would be 6%)

demand loan would depend on the length of time during each taxable period that the loan remained outstanding. Assuming an appropriate annual interest rate of 6%, an interest free demand loan of $100,000 would result in an annual gift of $100,000 x .06 or $6,000.

B. Income Tax

The Seventh Circuit in *Crown*, as well as the Tax Court, referred to a series of cases beginning with *Dean* v. *Commissioner*, 35 T.C. 1083 (1961), non acq., 1973-1 Cum. Bull. 4, holding that interest-free loans in non-gift settings (*i.e.*, between corporation and shareholder or employer and employee) do not result in taxable income to the borrower (67 T.C. at 1063, 1064; 585 F.2d at 240).[37] But, as the court below observed (Pet. App. 12a n.8), those cases do not present the question of the gift taxation of transactions between family members. Although interest-free loans may occur both in intra-family and corporation/shareholder (or employer/employee) situations, it

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of $100,000 x .558395 or $55,839.50. See 26 C.F.R. 25.2512-9(f), Table B, col. 4.

[37] See *Parks* v. *Commissioner*, 686 F.2d 408 (6th Cir. 1982), aff'g 40 T.C.M. (CCH) 1228 (1980); *Baker* v. *Commissioner*, 677 F.2d 11 (2d Cir. 1982), aff'g 75 T.C. 166 (1980); *Commissioner* v. *Greenspun*, 670 F.2d 123 (9th Cir. 1982), aff'g 72 T.C. 931 (1979); *Beaton* v. *Commissioner*, 664 F.2d 315 (1st Cir. 1981), aff'g 40 T.C.M. (CCH) 1324 (1980); *Martin* v. *Commissioner*, 649 F.2d 1133 (5th Cir. 1981), aff'g 39 T.C.M. (CCH) 531 (1979), also aff'g *Zager* v. *Commissioner*, 72 T.C. 1009 (1979) and *Creel* v. *Commissioner*, 72 T.C. 1173 (1979); *Suttle* v. *Commissioner*, 625 F.2d 1127 (4th Cir. 1980); *Trowbridge* v. *Commissioner*, 41 T.C.M. (CCH) 1302 (1981). See also *Joseph Lupowitz Sons, Inc.* v. *Commissioner*, 497 F.2d 862, 868 (3d Cir. 1974); *Saunders* v. *United States*, 294 F. Supp. 1276 (Hawaii 1968), rev'd on other grounds, 450 F.2d 1047 (9th Cir. 1971).

would ordinarily be only in the former situation that there could be a taxable gift.[38] An interest-free loan between a corporation and a shareholder or between an employer and an employee would almost always be a business transaction, and therefore would not have any gift tax consequences. See *Wemyss*, *supra*, 324 U.S. at 306. See also 26 C.F.R. 25.2511-1(g)(1), 25.2512-8. Accordingly, any tax consequences of such transactions would be income tax consequences, and thus have no relevance here.[39]

In any event, the *Dean* line of cases is based on a rationale that is peculiar to the income tax and has no application to the gift tax. The court below expressed this rationale as follows: "If the receipt of an interest free loan [in a non-gift setting] is taxed [as income] because it is the equivalent of the payment of additional income by which to obtain the loan (*i.e.*, with which to pay interest), then a deduction based on the payment would also be available."

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[38] Indeed, corporations as such are not subject to the gift tax; a gift by a corporation is treated as a pro rata gift by its shareholders. See 26 C.F.R. 25.2511-1(h)(1).

[39] Compare the definition of "gift" for gift tax purposes in *Commissioner* v. *Wemyss*, *supra*, 324 U.S. at 306-307 (donative intent is irrelevant; gift results from any transfer "not made in the ordinary course of business * * * to the extent that it is not made 'for an adequate and full consideration in money or money's worth' ") with the definition of "gift" for income tax purposes (see 26 U.S.C. 102) in *Commissioner* v. *Duberstein*, 363 U.S. 278, 285 (1960) (gift requires a " 'detached and disinterested generosity,' " quoting *Commissioner* v. *LoBue*, 351 U.S. 243, 246, (1956)). See also *Commissioner* v. *Beck's Estate*, 129 F.2d 243, 246 (2d Cir. 1942) ("Perhaps to assuage the feelings and aid the understanding of affected taxpayers, Congress might use different symbols to describe the taxable conduct in the several statutes, calling it a 'gift' in the gift tax law, a 'gaft' in the income tax law, and a 'geft' in the estate tax law.").

Thus, the courts have reasoned in these cases that any additional income to the borrower would be exactly offset by a deduction for interest paid under 26 U.S.C. 163, so that there would be a complete "wash." See, *e.g.*, *Parks* v. *Commissioner*, 686 F.2d 408 (6th Cir. 1982); *Baker* v. *Commissioner*, 677 F.2d 11 (2d Cir. 1982); *Commissioner* v. *Greenspun*, 670 F.2d 123, 125 (9th Cir. 1982); *Dean*, *supra*, 35 T.C. at 1090.[40] It is the government's position that

[40] In *Hardee* v. *United States*, No. 84-79 (Fed. Cir. May 11, 1983), reh'g denied (July 6, 1983), rev'g No. 84-79T (Ct. Cl. July 6, 1982), a shareholder who received interest-free loans from a corporation apparently used the loan proceeds to acquire tax exempt municipal bonds. Had the shareholder paid interest on those loans, he would not have been able to deduct that interest by virtue of 26 U.S.C. (Supp. V) 265(2), which denies deductions for, *inter alia*, "[i]nterest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from" income tax. The Claims Court accepted the government's argument that *Dean* was wrongly decided and held that the taxpayer had received taxable income. The Federal Circuit reversed, holding that "the definition of taxable income was never intended to encompass the free, temporary use of corporate money by a majority shareholder officer" (*Hardee*, *supra*, slip op. 10), and concluding that it was immaterial whether the shareholder would have been denied a deduction for interest under 26 U.S.C. (Supp. V) 265(2) had he paid interest for the borrowed funds. This holding is contrary to *Glenshaw Glass Co.*, *supra*, where this Court stated that Congress exerted " 'the full measure of its taxing power' " in enacting the income tax (348 U.S. at 429, quoting *Helvering* v. *Clifford*, *supra*, 309 U.S. at 334) and that it was the "intention of Congress to tax all gains except those specifically exempted" (348 U.S. at 430). The holding in *Hardee* also is contrary to many decisions holding that shareholder use of corporate property results in taxable income. See, *e.g.*, *Gardner* v. *Commissioner*, 613 F.2d 160 (6th Cir. 1980) (automobile); *Chandler* v. *Commissioner*, 119 F.2d 623 (3d Cir. 1941) (residence); *Challenge Manufacturing Co.* v. *Commissioner*, 37 T.C. 650 (1962)

those cases were wrongly decided.[41] But, in any event, since in the gift tax context there is no offsetting de-

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(boat); *Frueauff* v. *Commissioner*, 30 B.T.A. 449 (1934) (apartment).

The majority's statement in *Hardee* that the *Dean* line of cases was not based on the rationale that the borrower would be entitled to an offsetting deduction is factually wrong, as Judge Kashiwa noted in his dissent (*Hardee, supra*, slip op. 15-10). The Tax Court in *Dean* specifically distinguished the cases holding that personal use of corporate property results in income as follows (35 T.C. at 1090; footnote omitted):

> [H]ad petitioners borrowed the funds in question on interest-bearing notes, their payment of interest would have been fully deductible by them under section 163, I.R.C. 1954. Not only would they not be charged with the additional income in controversy herein, but they would have a deduction equal to that very amount. We think this circumstance differentiates the various cases relied upon by the Commissioner * * *.

Indeed, the courts following *Dean* have explicitly stated that their holdings turned on the offsetting deduction for interest paid. See *Parks, supra*, 686 F.2d at 409; *Baker, supra*, 677 F.2d at 11; *Greenspun, supra*, 670 F.2d at 125, 72 T.C. at 947 ("In holding that no income was realized by the taxpayers in *Dean*, however, we reasoned that had the taxpayers borrowed the funds on interest-bearing notes, their payment of interest would have been fully deductible under section 163."); *Beaton, supra*, 664 F.2d at 316-317; *Martin, supra*, 649 F.2d at 1133-1134; *Suttle, supra*, 625 F.2d at 1128.

[41] The assumption in those cases that whether an item is includible in income under 26 U.S.C. 61 depends on whether an offsetting deduction is available is simply wrong. In addition, the courts' assumption that there would be an offsetting deduction available for interest (neither charged, paid, nor accrued) is patently erroneous. Section 163 of the 1954 Code permits a deduction for interest paid or accrued, and since no interest was in fact paid or accrued, no deduction would be available. The hypothetical "offsetting deduction" is exactly that—hypothetical.

duction against the amount of the gift to which the lenders would be entitled, those cases, even if correct, would offer no support to the petitioners (see Pet. App. 13a n.8).

To the contrary, those cases in fact support the result below, since they reason that the tax consequences of an interest-free demand loan should be the same as the case of an interest-bearing loan accompanied by a transfer of additional money that the borrower uses to pay the interest on the loan (see, *e.g.*, *Greenspun*, *supra*, 72 T.C. at 947-948). Had the Dickmans made interest-bearing loans to Lyle and Artesian, and then given them money to pay the interest on those loans, there could be no doubt that the additional money would constitute taxable gifts to the borrowers (Pet. App. 12a-13a n.8).[42]

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[42] Petitioners (Br. 38-42) seek support in cases where the government argued that a portion of the payments received in interest-free installment sales should be treated as interest and not as sales proceeds, and also in cases where the government sought to treat the lender of money at a less than arm's length rate of interest as having realized additional interest income. Petitioners note that the courts rejected the Commissioner's claims in those cases and Congress responded with specific statutes, *i.e.*, 26 U.S.C., (& Supp. V) 483 (providing for recharacterization of certain installment sales proceeds as constituting unstated interest) and 26 U.S.C. 482 (providing for reallocation of income and deductions between commonly controlled businesses). Those cases, and those statutes, are not relevant here. The court below did not recharacterize sales proceeds as something else, nor did it allocate income in any sense. Rather, the court simply held that, since the borrowers here were given property for which they paid no consideration, taxable gifts resulted.

IV. THE HOLDING BELOW CREATES NEITHER ADMINISTRATIVE PROBLEMS NOR ANOMALIES IN THE TAX LAWS

A. Insignificant Loans

The Tax Court and the Seventh Circuit in *Crown* were concerned that the Commissioner's view of the tax consequences of interest-free loans would lead to IRS involvement in "a multitude of situations involving gratuitous use or sharing of real or personal property among relatives" (67 T.C. at 1065) and friends (585 F.2d at 241). These perceived administrative problems are largely if not entirely illusory, because the gift tax exclusion and credit provisions will cover virtually all such transfers. Section 2503 (b) of the 1954 Code (26 U.S.C. (Supp. V)) now provides that a taxpayer may annually give up to $10,000 to each of any number of persons without incurring any gift tax liability.[43] In addition, should a taxpayer make a gift during one year worth more than $10,000 to any one person, the taxpayer would not incur any gift tax liability until he has exhausted his credit under 26 U.S.C. (& Supp. V) 2505 (which replaces the $30,000 lifetime exemption under former 26 U.S.C. 2521, applicable in the taxable periods involved in this case). For gifts made in 1983, the tax credit under Section 2505 is $79,300, which is equivalent to a lifetime exemption for gifts of a value of $275,000. (Under the Economic Recovery Tax Act of 1981, this credit is increased each year to 1987,

[43] In the taxable periods involved in this case, Section 2503(b) provided for an annual exclusion of $3,000 per donee. Effective for transfers after December 31, 1981, the annual exclusion under Section 2503(b) was raised to $10,000. See the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 441(a), 95 Stat. 319.

when it will be $192,800, equivalent to a lifetime exemption for gifts worth $600,000.[44]) Thus, for a taxpayer today to incur a gift tax liability (assuming he has available his full credit under Section 2505), he would have to make a gift to one person during one year of more than $285,000 ($275,000 plus $10,000). A taxpayer would have to confer an interest-free demand loan for the entire year of more than $1,425,000 to result in such a gift (assuming an arm's length interest rate of 20%).[45] Clearly, lending a neighbor one's lawnmower or one's automobile or putting up guests for a night (see *Crown*, *supra*, 585 F.2d at

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[44] See 26 U.S.C. 2505, as amended by the Economic Recovery Act of 1981, Pub. L. No. 97-34, Section 401(b), 95 Stat. 299.

[45] Other statutory provisions may apply so as to limit further the application of the gift tax to substantial transfers. For example, under 26 U.S.C. (Supp. V) 2513(a) an election may be made to treat a gift in fact made by one spouse as made half by each spouse. Each spouse could then apply a separate $10,000 exclusion and gift tax credit to the portion of the gift he or she is deemed to have made. Thus, if married taxpayers had available their full credits under Section 2505, their election under Section 2513(a) to "split" the gift would permit them to loan on demand $2,850,000 in one year to one person (assuming a 20% interest rate) without incurring gift tax liability.

In addition, new 26 U.S.C. (Supp. V) 2503(e), added by Section 441(b) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 319, excludes from taxable gifts any amount paid on behalf of an individual (1) as tuition at a qualified educational institution and (2) for medical care, so that any such payments would not deplete a taxpayer's Section 2505 credit. Finally, expenditures to discharges one's legal obligation to support one's family have traditionally been viewed as not subject to the gift tax. R. Stephens, G. Maxfield, S. Lind & D. Calfee, *supra*, at ¶ 10.02[5]; *cf. Harris v. Commissioner*, 340 U.S. 106 (1950).

241) would not subject the ordinary taxpayer to any gift tax. While it is true that a taxpayer who has exhausted his Section 2505 credit would be subject to tax if he makes an interest-free loan to a donee (to whom he has already given $10,000 that year), he would also be subject to tax on any additional gift of cash or other property, however insignificant its value, to that same donee.[46]

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[46] Amicus D'Ancona & Pflaum asserts that "[f]ew people file gift tax returns every year," and contends that, because there is no statute of limitations for assessment of gift taxes where no return is filed, "affirmance of the decision below may apply to gift tax periods all the way back to 1932" (Br. 3). Although Amicus is correct that the average person does not file gift tax returns, persons who were sufficiently wealthy to be able to make interest-free loans that would be subject to the gift tax would very likely have been required to file returns anyway because of other gifts they made, not involving loans. Consequently, if those individuals filed returns, as they were required to do, assessment of any additional tax liability would be barred by the applicable statute of limitations. See, *e.g.*, Revenue Act of 1932, ch. 209, Section 517(a), 47 Stat. 254 (3 year statute of limitations on assessment of gift tax liability).

The gift tax has always included a provision permitting taxpayers to make substantial gifts to an unlimited number of persons each year without resulting in a gift tax liability. This exclusion was $5,000 for gifts made from 1932 through 1938 (Revenue Act of 1932, ch. 209, Section 504(b), 47 Stat. 247); $4,000 for gifts made from 1939 through 1942 (Revenue Act of 1938, ch. 289, Section 505, 52 Stat. 565; Internal Revenue Code of 1939, ch. 2, Section 1003(b), 53 Stat. 146); $3,000 for gifts made from 1943 through 1981 (Revenue Act of 1942, ch. 619, Section 454, 56 Stat. 953; Internal Revenue Code of 1954, ch. 736, Section 2503(b), 68A Stat. 404); and $10,000 for gifts made after 1981 (Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 441(a), 95 Stat. 319). In addition, the gift tax always has included a substantial "lifetime exemption" (now a credit) applicable to the total amount of gifts made by resident taxpayers. This exemption was $50,000 from

B. Valuation

The Seventh Circuit (*Crown*, *supra*, 585 F.2d at 240-241) and petitioners (Br. 34) also assert that the valuation of the gift resulting from an interest-free loan poses substantial administrative and judicial problems. But it should be relatively easy to determine the appropriate interest rate for a loan with a reasonable degree of accuracy as, for example, through the testimony of a bank officer who is familiar with prevailing interest rates. An interest-free demand loan presents no greater valuation problems than does an interest-free or low interest term note, which the courts have regularly valued without difficulty (see *Berkman* v. *Commissioner*, *supra*; *Blackburn* v. *Commissioner*, *supra*; *Mason* v. *United States*, *supra*). Indeed, the courts routinely value property interests that are vastly more difficult to evaluate than the interests involved here. See, *e.g.*, *Wallace* v. *United States*, 82-1 U.S. Tax Cas. (CCH) ¶ 13,442 (Mass. 1981) (nonvoting common stock in closely held corporation); *Smith* v. *Commissioner*, 41 T.C.M. (CCH)

1932 through 1935 (Revenue Act of 1932, ch. 209, Section 505(a)(1), 47 Stat. 247); $40,000 from 1936 through 1941 (Revenue Act of 1935, ch. 829, Section 301(b), 49 Stat. 1025; Internal Revenue Code of 1939, ch. 2, Section 1004(a)(1), 53 Stat. 147); and $30,000 from 1942 through 1976 (Revenue Act of 1942, ch. 619, Section 455, 56 Stat. 953; Internal Revenue Code of 1954, ch. 736, Section 2521, 68A Stat. 410). In 1976 the lifetime exemption was converted to a credit. See 26 U.S.C. (Supp. V) 2505. Thus, for a taxpayer to have incurred a gift tax liability in 1932, for example, he would first have had to have exhausted his lifetime exemption of $50,000 and, in addition, have given more than $5,000 to one person. For an interest-free demand loan to result in a gift of $5,000, even assuming an interest rate of 3%, a taxpayer would have had to have lent more than $166,000 to one person for a full year.

1427 (1981) (patents for a liquid propulsion system); *Webster Investors, Inc.* v. *Commissioner*, 19 T.C.M. (CCH) 396 (1960) (brand name).[47] But even if it were difficult to value the instant gifts, that would not affect their taxability. As this Court stated in *Smith* v. *Shaughnessy*, *supra*, 318 U.S. at 180:

> Even though these concepts of property and value may be slippery and elusive they can not escape taxation so long as they are used in the world of business. The language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent.

See also *Galt* v. *Commissioner*, 216 F.2d 41, 50 (7th Cir. 1954), cert. denied, 348 U.S. 951 (1955).

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[47] The valuation problems in cases involving interest-free loans are no different from those involving tangible property, such as an automobile having an agreed fair market value of $10,000. If the taxpayer transfers the car to his son in consideration for the son's promise to return the car, or an identical car, to the taxpayer one year later, there is a gift of the right to use the car for one year. An officer of an automobile rental company could testify as to the amount of one year's rental of the car, *i.e.*, as to the value of the gift. If the taxpayer transfers the car to his son in consideration for the son's promise to return the car, or an identical car, to the taxpayer upon demand, there is a gift of the right to use the car through the period prior to the taxpayer's demand for return. In this case also, an officer of an automobile rental agency could testify as to the value of the gift. If the property transferred from the taxpayer to the son is money rather than an automobile, and the son's undertakings with respect to retransfer are the equivalent of those above, the equivalent results would follow, except that an officer of a bank rather than an officer of an automobile rental agency should testify as to the value of the gift of the right to use the property lent.

C. Double Counting

Petitioners and amici contend that the decision below creates inconsistencies in the tax law. For example, Amicus Jones, Day alleges (Br. 18) that "the Commissioner is 'double counting' when he treats the borrower of an interest-free demand loan as the recipient of both a gift and of income on the borrowed funds." Amicus maintains, instead, that if the loans result in taxable gifts by the lenders, the borrowers should be able to exclude from their taxable income any interest they earn on the loans, "since this is precisely the benefit alleged to be received by gift" (*id.* at 16).

This argument is specious. Section 102 of the 1954 Code, which excludes from gross income "the value of property acquired by gift," specifically provides that the exclusion does not extend to "the income from any [such] property." Lyle and Artesian here received a gift of property (consisting of the right to use money) and requiring them to include in their incomes any earnings generated by that property no more results in "double counting" than does taxing any donee on the income from any property received as a gift, such as the rental income on a house received as a gift. Amicus' argument rests on the mischaracterization of the instant gifts as gifts of interest. In fact, the gifts here were not of interest, but rather of property rights, consisting of the right to use money, and the only relevance interest has is that the value of the property transferred is measured by reference to the interest rate that would be charged on a similar loan.[48] Indeed, the loans need

[48] The courts in *Crown, supra*, 585 F.2d at 236, 240, and *Johnson, supra*, 254 F. Supp. at 77, made a similar mistake in suggesting that the Commissioner was attempting to tax "im-

not even generate interest income to the borrowers. Although the borrowers might choose to deposit the loan proceeds in a bank and earn interest, they could as well use the loan proceeds to purchase stock or real estate, and it is clear that the earnings so generated (*e.g.*, dividends, rental income or capital gains) should be included in their income.

D. Loans Versus Outright Gifts

Amicus Jones, Day also observes (Br. 19-20) that "the gift tax on an amount lent to another can be greater than * * * the gift tax on the same amount *given outright*," and asserts that this results in double taxation and is senseless. To the contrary, however, this result is quite logical because of the "time value" of money.[49] The Seventh Circuit in *Crown* explained this alleged "paradox" as follows (585 F.2d at 239 n.14):

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puted interest," and rejecting that attempt on the ground that taxpayers are under no legal obligation to charge such interest, especially to their children. There is, of course, no legal requirement that parents charge their children interest on loans; there is likewise no legal requirement that parents charge for any property they might choose to give their children. But the fact remains, if they do transfer property for less than full consideration, that is a taxable gift. The courts erroneously assumed that, for there to be a gift, the lender must forgive some obligation due him. Under that rationale, no gift of property would be taxable, since the government could be said to be attempting to impose a tax on an imputed payment for that property which the donor was, in fact, under no obligation to charge.

[49] The "time value" of money reflects the fact that "a dollar received at once is worth more than a dollar to be received at some date in the future." O'Hare, *The Taxation of Interest-Free Loans*, *supra*, 27 Vand. L. Rev. at 1088.

> [I]f a lender makes a $1,000 no-interest loan and the "proper" interest rate is 10% under the IRS formula he would be treated as having made a gift of $100 in each year the loan remains outstanding. Thus, if the loan remains outstanding for 20 years, he will be treated as having made gifts totaling $2,000, whereas he would only have been taxed on $1,000 if he had made a gift of the principal in the first place. However, the paradox is one of nominal rather than real values. In the case of the outright gift the tax is paid immediately, while under the loan the tax is paid at various points in the future. Because of the time-value of money, the present value of the two alternatives may be about the same.

Indeed the same "paradox" results in situations where even the Amicus would concede there are gifts. For example, suppose a house worth $100,000 would rent for $10,000 per year. If a taxpayer made an outright gift of the house, he would have made a taxable gift of $100,000, but if he made a series of gifts of rent-free term leases, after 20 years he would have made gifts totalling "twice" the house's value.

E. Loans to Charitable Organizations

Petitioners argue (Br. 6-7) that an interest-free loan to a charitable organization would result in the following "obviously unintended anomal[y]":

> An outright gift of money to charity would not be a taxable gift but would give rise to an income tax deduction, while an interest-free loan to that charity would be a taxable gift but no income tax deduction would be allowed.

See also *id.* at 30. But this result is in no way peculiar to interest-free loans; it occurs whenever a taxpayer transfers to a charity the cost-free right

to use any of his property. For example, if a taxpayer makes an outright gift of a building to a charity, he makes a taxable gift, but, in computing the gift tax, he has an offsetting deduction under 26 U.S.C. (& Supp. V) 2522(a), as well as a deduction (for purposes of income tax) under 26 U.S.C. 170. In contrast, if the taxpayer gives the charity a rent-free lease to the building, the fair rental value of the lease is a taxable gift, but the taxpayer is denied an offsetting deduction under 26 U.S.C. (& Supp. V) 2522(c), and also is denied any deduction for income tax purposes under 26 U.S.C. 170(f)(3). See 26 C.F.R. 1.170A-7(d), Examples (1) and (3). These tax consequences are mandated by the Code and reflect Congress's intent to remedy perceived abuses in the contribution to charities of certain partial interests in property.[50]

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[50] Prior to the Tax Reform Act of 1969, courts held that a taxpayer could grant a charity the right to use the taxpayer's property rent free, and obtain a charitable deduction under 26 U.S.C. 170 for the fair market value of the right to use that property. See, *e.g.*, *Threlfall* v. *United States*, *supra*. This, however, resulted in a double benefit for the taxpayer, since courts also held that the taxpayer was not required to include in income the fair market rental value of the property. See *Threlfall*, *supra*, 302 F. Supp. at 1120. See also H.R. Rep. No. 91-413 (Pt. 1), 91st Cong., 1st Sess. 57-58 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 83 (1969). Congress eliminated this double benefit by enacting 26 U.S.C. 170(f)(3), which, in general, disallows deductions for income tax purposes for contributions of certain temporal interests in property. Because of additional perceived abuses in the gift tax area, Congress simultaneously amended Section 2522(c) to permit deductions for gift tax purposes for contributions of partial interests in property only where those interests meet certain strict requirements. See H.R. Rep. No. 91-413 (Pt. 1), *supra*, at 58-60; S. Rep. No. 91-552, *supra*, at 86-93.

In sum, the decision below is entirely consistent with generally applicable principles of the tax law and, as we have previously shown, is mandated by the pertinent statutory language and legislative history.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ESTHER C. DICKMAN AND
ESTATE OF PAUL B. DICKMAN, DECEASED,
G. WENDELL SMITH, PERSONAL REPRESENTATIVE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**On Writ of Certiorari
to the United States Court of Appeals
for the Eleventh Circuit**

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QUESTION PRESENTED

Is a failure to demand repayment of an interest-free demand loan a "transfer of property by gift" subject to the federal gift tax?

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ARGUMENT

I. THE IRS HAS FAILED TO DEMONSTRATE THAT CONGRESS INTENDED TO SUBJECT INTEREST-FREE DEMAND LOANS TO GIFT TAXATION.

The Commissioner of Internal Revenue (hereinafter "IRS") correctly and at length points out in his Brief that the Congress which enacted the gift tax law in 1932 intended to reach a wide variety of transfers. Brief for the Respondent at 7-15. Despite its best efforts, however, the IRS cannot overcome either of the twin obstacles to its effort to expand by judicial decision the scope of the gift tax: the history of Congressional and administrative action in this area and the less-than-infinite elasticity of the concept of a "transfer of property by gift." For these reasons, the IRS ultimately fails — as it must — to demonstrate that Congress sought to impose gift tax in connection with interest-free demand loans based upon a theory that there is a taxable gift of the "right to use" the sums loaned.

A. The IRS Can Point to No Credible Evidence in the Legislative or Administrative History of an Intention to Make Interest-Free Demand Loans the Subject of Gift Taxation.

Historically, the argument of the IRS rests on nothing more than the breadth of the statutory language, of statements in Committee Reports, and of regulations which largely track either or both. The IRS simply has not directed this Court's attention to any historical reference whatsoever — whether in the gift tax law itself, the legislative history, or regulations — to loans (much less demand loans) as intended subjects of gift taxation. Instead, it must rely on bald assertions that the gift tax is "all-inclusive" and suggestions that any such reference to loans was unnecessary in light of the "broad sweep" of the statute. Brief for the Respondent at 10, 11. The repetition of such general assertions by the IRS, however, serves only to emphasize its

inability to offer any solid evidence that even a single member of the Seventy-second Congress would have concurred in the interpretation of the gift tax statute for which the IRS now contends.

Perhaps more importantly, the argument of the IRS fundamentally misconceives the significance of the use by Congress of broad language in the gift tax law. Such statutory breadth serves the important purpose of precluding future frustration of the tax as a result of the development of novel tax-avoidance techniques which Congress could not foresee at the time of enactment and which might fall outside more narrowly-drawn provisions. The broad terms used in the 1932 gift tax statute were *not* intended, however, to encompass transactions of a kind which were common at the time of enactment, but which would never have been thought by that Congress to constitute "gifts." The loans by the Dickmans were clearly of this description, and the breadth of the statutory language therefore has no significance to the issue before the Court in this case.

The IRS admits, as it must, that interest-free demand loans within families were common features of American life when the gift tax statute now before the Court was enacted. Brief for the Respondent at 14 n.19. Similarly, the IRS makes no assertion that the loans made by the Dickmans were less than *bona fide* in any respect, or were motivated by any desire to lessen or avoid taxes.[1] *See* Pet. A. 22a n.4. Thus, the conclusion is inescapable that the loans at issue in this case were not "novel tax-avoidance techniques," and in fact were no different in kind from those which were common in 1932, or for that matter 1832.

[1]The IRS does suggest that demand loans within families "may have characteristics resembling outright gifts of money," Brief for the Respondent at 25, but retreats from any assertion that the loans at issue in this case were not intended by all parties to be repaid. The reason for the insinuation is apparent: the IRS wants this Court to think of interest-free demand loans as tax-avoidance devices, as "disguised gifts," without bearing the burden of proving that they were used in this manner by the Dickmans. In fact, it is quite clear that the IRS could not meet that burden in this case, where there were substantial loan repayments, where the amounts loaned by Paul Dickman were fully taxed in his estate, and where there is no evidence of any disparity in the marginal income tax rates of the lenders and borrowers.

The Congress which passed the gift tax law now before this Court undoubtedly was aware that parents often loaned their children money or other property without demanding interest. Indeed, it reasonably can be supposed that many members of that Congress had been the recipients of such loans from their parents, and the source of such loans to their children as well. Had that Congress truly intended to subject to the gift tax such a familiar transaction — and one which was so far different from the common, or common law,[2] concept of a "gift"[3] — would it have failed to make even the slightest reference to such an

[2]The Commissioner claims that cases establishing the common law meaning of a "gift" have no relevance here, citing this Court's decision in *Commissioner v. Wemyss*, 324 U.S. 303, 306 (1945). Brief for the Respondent at 11 n.14. Because a demand loan is the antithesis of a common law gift — which requires an irrevocable and present divestment of any interest in the property by the donor — the Commissioner's overstatement is not surprising. However, the Court's decision in *Wemyss* plainly did not go so far. The Court there noted that technical common law requirements such as "donative intent" and an entire absence of consideration were inconsistent with, and supplanted by, the "workable external test" of Section 503 of the Revenue Act of 1932, ch. 209 (now I.R.C. § 2512):

> [W]here property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeds the value of the consideration shall ... *be deemed a gift*.... (emphasis added).

The Congress thus implicitly recognized that such transactions might not actually be "gifts" as defined in Section 501 of the 1932 Revenue Act — which levied the tax on "transfers of property by gift" — but nevertheless should be "deemed" as such "for the purpose of the tax imposed by this title."

Thus, where a transaction clearly falls within Section 503, the Congress intended that it should be subject to tax regardless of technical common law requirements, and this Court so held in *Wemyss*. Where, as here, no such conclusion is possible, it cannot be said that the common law is of no relevance. In such instances, the Court must interpret the bedrock statutory phrase of "transfer of property by gift" — a phrase placed in the statute by a Congress which included many fine lawyers well aware of its common law meaning. The common law thus is highly relevant to the determination of Congressional intent in using this phrase, and *Wemyss* clearly does not negate the appropriateness of resort to the common law for this purpose.

[3]"A loan is not a gift; the terms 'to give' or 'to donate' are the precise antithesis of the term 'to loan', which implies a promise to repay or return. An obligation to return or repay the thing received, or to pay interest thereon, or even an expectation of repayment is inconsistent with the theory of a gift." *Zeller v. Zeller*, 396 So. 2d 1177, 1179 (Fla. App. 1981), *quoting* 38 C.J.S. *Gifts* § 6.

intention? The self-evident answer is no, and it is solidly reinforced by the failure of the IRS to seek to impose a tax in connection with demand loan transactions for over thirty years thereafter.

Despite its history of inaction in this area until the 1960's, the IRS makes the remarkable claim that "it was nevertheless reasonably clear from earlier regulations that the gift tax does reach the value conferred by interest-free demand loans." Brief for the Respondent at 14-15. The primary authorities offered for this assertion are the regulations under 26 U.S.C. (hereinafter "I.R.C.") § 2511, 26 C.F.R. (hereinafter "Treas. Reg.") § 25.2511-2. These regulations, however, not only do *not* make it "reasonably clear" that demand loan transactions would result in gift taxation, but strongly indicate the opposite.

The regulations at § 25.2511-1(h) list ten detailed examples of "transactions resulting in taxable gifts." Conspicuous by their absence are examples involving demand loans, or any loans. In each example which does appear, a taxable gift occurs only upon an actual transfer of property, and not upon the mere creation of a "right to use" property which falls short of such a transfer. For example, Treas. Reg. § 25.2511-1(h)(4) discusses the creation of a joint bank account by A for himself and B, upon which either can draw without the consent of the other and without an obligation to account to the other for proceeds drawn from the account. In such an instance, B plainly has the right to draw out all funds in the account at any time and invest them at a market rate of interest. Despite this "right to use" the funds, a taxable gift occurs only when B actually draws such funds out of the account and only "to the extent of the amount drawn." Even if B has allowed the funds to remain in a non-interest-bearing checking account for years, the amount of the gift is to be determined by the amount actually received by B, and not by an amount which B theoretically had the "right to use."

Similarly, Treas. Reg. § 25.2511-2(c) makes it clear that a transfer by gift is incomplete, and therefore not taxable, "in every instance in which a donor reserves the power to revest the beneficial title to the property in himself." In such instances, a taxable gift occurs only if and to the extent that there is actual "receipt of income or other enjoyment of the transferred property" by another. Such a gift is deemed to have been made "as of the calendar quarter or calendar year of its receipt." Treas. Reg. § 25.2511-2(f). Although these provisions are offered by the IRS in support of its contention, Brief for the Respondent at 12-13, they in fact provide strong evidence against it. The regulation — like the gift tax statute itself — is concerned with actual *receipt* of money or other property as a result of a transfer, not imputed values of a "right-to-use" which may or may not be exercised. If such a theory had been envisioned as a part of the law by the framers of the regulations, it is inconceivable that they would have used the language which they did, or that they would have omitted any mention of that theory or of interest-free loans, as in fact occurred. Thus, the regulations strongly negate the disingenuous contention of the IRS that it was always "reasonably clear" that interest-free demand loans were subjects of gift taxation.

B. The "Right to Use" Theory of the IRS Extends Far Beyond the Reasonable Bounds of the Statutory Language.

The truth is that the argument of the IRS in this case has nothing to do with actual Congressional intent. It represents instead an attempt to write into the gift tax law the economic concept of the "time-value of money," and the corollary idea that the mere opportunity to invest or otherwise use money — whether or not exercised — itself constitutes "property" and should be the subject of gift tax. The "time-value" concept is, of course, one which has become increasingly familiar to many Americans in the inflationary economy of the last two decades. Indeed, the position of the IRS might make sense to the Congress

of the 1980's in terms of economics, equity, and tax policy — or it might not. Until it is presented to Congress, no one can safely predict the outcome. But one can state with confidence that this "time-value" concept was no part of the intellectual currency of the Seventy-second Congress, and was not incorporated in the term "transfer of property by gift" as used by that Congress.[4]

In making that statement, it is not necessary to rely alone on the statute and its legislative and administrative history, however compelling they may be. One can also consider the history of the efforts of the IRS to write a comparable concept into the income tax law with respect to interest-free loans in cases ranging in time from *Dean v. Commissioner*, 35 T.C. 1083 (1961), *nonacq.*, 1973-1 C.B. 4, to the recent decision of the Court of Appeals for the Federal Circuit in *Hardee v. United States*, 708 F.2d 661 (Fed. Cir. 1983). In the income tax area as well as the gift tax area, the IRS first began asserting its current position in the 1960's, has relied heavily on the breadth of the applicable statute in the absence of specific language supporting its contention, and has sought to impose a tax on the basis of an imputed benefit irrespective of whether or not actual money or property has been earned through use of the money loaned.[5] In each instance from *Dean* to the present, the courts ultimately have rejected the IRS position. *Cf. Wells Fargo Bank v. Cory*, 110 Cal. App. 3d 242, 167 Cal. Rptr. 778 (1st Dist. 1980)

[4]One illustration of the inconsistency between the gift tax statute as written and the "time value" economic concept is presented by the insistence of the IRS that it is "quite logical" to tax a twenty-year interest-free loan of money as a greater "gift" than an outright gift of the same amount. Brief for the Respondent at 40. The IRS can make this argument only by discounting the supposed value of the "right to use" the money loaned to the date of the initial loan — a date when the IRS admits no "gift" was made under the statute as written. *Id.* at 13. The IRS must also, of course, ignore the common-sense reality that any person offered the choice of an outright gift of $100 or a twenty-year loan of $100 would have no difficulty in determining that the former alternative presented the greater opportunity.

[5]The IRS also acted in the same year both to state its non-acquiescence in *Dean*, 1973-1 Cum. Bull. 4, and to reject, in Rev. Rul. 73-61, 1973-1 C.B. 408, the rationale of *Johnson v. United States*, 254 F.Supp. 73 (N. D. Tex. 1966).

(holding that interest-free demand loans do not result in "transfers by gift" under California gift tax statute).

The conclusion of the court in *Hardee* is highly relevant to the issue before this Court:

> From the inception of our modern income tax laws in 1913 until *Dean* in 1961, the treasury never took the position that an interest-free loan by a corporation to its shareholder-officers resulted in the realization of income. During this period, the Internal Revenue Code has defined income in broad and sweeping terms, yet the government did not see fit, either in litigation or by rule, regulation, or administrative practice, to treat such loans as a taxable event.
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> In sum, it took the government nearly 50 years before it thought to treat the receipt of an interest-free loan as a taxable event, and over 20 years of case law has since held to the opposite view.... In reversing the decision of the trial judge, we do not disparage his economic analysis of the transaction. Rather, we follow the *Dean* holding because it represents a well-entrenched interpretation that has logical support.

708 F.2d at 663, 664. Petitioners respectfully submit the same conclusion is fully warranted in the gift tax area, and the same result should follow.

In order to create even an illusion that the "time-value" concept can be forced within the statutory language of a "transfer of property by gift," the IRS must adopt the untenable position that term and demand loans may be equated for gift tax purposes. The IRS notes that the regulations provide that a gratuitous conveyance of a term estate constitutes a taxable gift of the value of the estate. Brief for the Respondent at 16. This is

hardly surprising: a discrete "transfer" has occurred on a specific date, and it may readily be valued and taxed as of that date.[6]

Such a result is no authority for imposition of tax in this case, however. Here the only remotely comparable events were the making of the interest-free loans, which involved discrete transfers of money in return for demand promissory notes of substantially equal value. The IRS admits that the interest-free loans "were not gifts of the sums transferred because [the borrower] agreed to repay those amounts on demand." Brief for the Respondent at 13. Nor does the IRS claim that a taxable gift even of a "right to use" occurred at the times the loans were made, for that "right" could be terminated at any moment and obviously was incapable of valuation at the dates of the loans.

The IRS thus does not seek to base a tax on this actual transfer, but only on theoretical "transfers" which purportedly occur continuously over the duration of the demand loan. It therefore seeks to equate the making of a term loan, which involves a real transfer of property, with the moment-by-moment continuance of an existing demand loan — which is nothing more than a failure to terminate an existing possibility of economic benefit on the part of the borrower. Unless the statutory term is simply to be ignored and the absence of any actual "transfer of property by gift" deemed irrelevant, the attempt of the IRS to equate these transactions must be rejected.[7]

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[6]Petitioners do not concede that term loans of money are proper subjects of gift taxation under current law. This issue is not before the Court in this case, however, in view of the factual findings of the Tax Court which are not here disputed.

[7]One difference in the tax treatment of term and demand loans, even if the claim of the IRS were accepted, would be obvious. A term loan would be valued and taxed as of the date made, and the amount of the gift would be subject to the $10,000 annual exclusion in that year. Under the theory of the IRS, demand loans would result in continuous "gifts" over the term of the loan and thus could be subject to multiple annual exclusions if the loan lasted for several years. Thus, the tax treatment of term and demand loans would not be equal even if the IRS contention were accepted.

Perhaps the clearest evidence that the "time-value" theory of the IRS is not currently a part of the gift tax law comes from the Treasury itself. On June 24, 1983, Robert G. Woodward, Acting Tax Legislative Counsel of the Department of the Treasury, appeared before the IRS Oversight Subcommittee of the Senate Finance Committee. In outlining areas of possible legislative action, Mr. Woodward stated:

> The high interest rates and inflation that we have experienced in recent years bring into question the economic assumptions that underlie certain provisions of the Internal Revenue Code. These high rates have resulted in a material increase in the "time value of money"....In many respects, the Code ignores time value of money concepts....[W]e believe the time has come for a fundamental reexamination of several provisions of the Code that do not properly take time value of money concepts into account.

Proposed Amendments to the Internal Revenue Code of 1954, as Amended: Hearings before the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance, 98th Cong., 1st Sess. (1983) (Statement of Robert G. Woodward), *reprinted in* Daily Tax Report (BNA) No. 123, J-4, J-7 (June 24, 1983) (hereinafter cited as *Woodward*). Mr. Woodward then set forth for the Subcommittee several such areas, including "Interest-Free Loans." After referring briefly to this case and *Crown v. Commissioner*, 585 F.2d 234 (7th Cir. 1978), he concluded:

> In our view, interest-free loans...should be treated for tax purposes as if interest actually had been paid at a market rate and rebated to the [borrower].[8] We recognize the need for a *de minimis* type exception in this area as well.

Woodward at J-10.

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[8]The language set forth in the bracketed portion of the quotation is made with the authorization of Mr. Woodward. Telephone conversation with Robert G. Woodward (October 14, 1983). The Court may wish to note that the Treasury proposal would require the lender to pay income tax as well as gift tax on the imputed receipt and "rebate" of interest.

Thus, at virtually the same time the IRS was preparing to argue to this Court that its "time-value" theory was embodied in the 1932 gift tax law and that no need for legislative action exists, the Treasury Department was frankly acknowledging the opposite to the United States Senate. In this respect, the statements of the Government before the Senate plainly belie its words to this Court. The IRS should now candidly acknowledge to this Court that it seeks to change the gift tax law and should attempt to do so in the Congress, which is the only proper forum for that effort. *See United States v. Byrum*, 408 U.S. 125, 135 (1972). If the IRS persists in attempting to import its "time-value" concept into the 1932 gift tax law, however, this Court should squarely reject that invitation to judicial legislation.

II. THE SERIOUS ADVERSE CONSEQUENCES OF ANY JUDICIAL ADOPTION OF THE THEORY OF THE IRS CANNOT EFFECTIVELY BE DENIED.

The IRS attempts in its Brief to greatly minimize or ignore the difficulties and anomalies which would result from any judicial adoption of its "time-value" theory in this case. In its view, many interest-free demand loans are of doubtful economic substance,[9] and a need exists to impose a gift tax to prevent possible abuses. Rather than employ the tools which it now has

[9]Brief for the Respondent at 25. The Dickmans vigorously dispute the general and unsupported assertions of the IRS with respect to alleged distinctions between demand loans in "arm's length" business and family contexts. In claiming that the lender typically reacts to deterioration of the borrower's financial position in opposite ways in the differing contexts — with the banker demanding payment while the family member does not do so and may extend further loans — the IRS betrays a lack of experience in the practical world of banking. Bankers quite commonly extend or increase loans or lines of credit during difficult periods for their customers, seek repayment only when the customer has "sufficient funds available," and allow such customers credit for "indefinite, extended periods" — all supposed characteristics only of intrafamily loans. *See* Brief for the Respondent at 25-27.

to identify and deal with such instances, however, the IRS seeks from this Court a blanket judicial ruling which would impose tax equally on those who engage in sham loans to evade taxation and those — like the Dickmans — who made *bona fide* loans in a family business context with neither the purpose nor effect of tax avoidance. The Court should not reward this overzealous effort on the part of the IRS, and should leave to the Congress the fashioning of a comprehensive remedy for any problem which may exist.

As noted by Mr. Woodward in his recent statement to the Senate, the Government is seriously — and, Petitioners submit, justly — concerned that some interest-free demand loans may be matters of form rather than substance:

> We believe many of the alleged interest-free loans used by taxpayers to attempt to shift income to lower-bracket taxpayers are not true loans. For example, there would be little economic substance to a non-recourse loan by Father to Son with the loan proceeds being invested in stock that is pledged as security for the loan.

Woodward at J-9, J-10. Mr. Woodward, unlike the IRS in its Brief, indicated by these comments a recognition that such instances of abuse may be attacked under long-recognized doctrines of tax law. For example, the IRS plainly has the power to demonstrate that what purports to be a demand loan is in fact a gift, and to tax it as such.

> The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance.

Chisholm v. Commissioner, 79 F.2d 14, 15 (2d Cir. 1935), *cert.*

denied, 296 U.S. 641 (1935) (Hand, L., J.). *See also Gregory v. Helvering*, 293 U.S. 465 (1935); Rev. Rul. 77-299, 1977-2 C.B. 343.

What the IRS seeks in this case, then, is not a tool necessary to effectively tax gifts that are in the guise of loans, or income earned in the name of a low-bracket taxpayer but in fact earned and controlled by a high-bracket taxpayer.[10] Such tools exist, and the loans at issue here plainly fall in neither category. The IRS instead seeks a broad judicial adoption of its "time-value" concept as a part of the gift tax law, one which would give it *carte blanche* to impose tax retroactively on those who have acted in bad faith and those who have acted in good faith alike.

In determining whether this result is appropriate, the Court may wish to consider still another example of the sweep of the principle for which the IRS contends.[11] Mrs. Hanora C. Dorn, a resident of McCormick, South Carolina, was a small (0.5 percent) shareholder in the only bank in her county. Her adult daughter owned 26 percent of the bank's stock and an unrelated family owned 73.5 percent of the shares. For several years prior to her death in 1980, Mrs. Dorn maintained a sizable checking account in the bank, which bore no interest. After her death, the

[10]The claim of the IRS that adoption of its "time-value" theory is necessary to preserve the efficacy of the statutory provisions enacted after this Court's decision in *Helvering v. Clifford*, 309 U.S. 331 (1940), also is without force. *See* I.R.C. § 671 *et seq.* The *Clifford* provisions are concerned with the taxation of income actually earned by short-term trusts, not the theoretical interest income which the IRS proposes to use to value alleged "gifts" in this case. Moreover, as noted by the Court in *Wells Fargo Bank v. Cory*, the *Clifford* trust and demand loan contexts are not comparable in terms of the control retained by the grantor or lender:

> [T] beneficiary of a trust cannot reach the corpus so the funds remain intact: in the loan situation, a borrower can consume the funds and the lender is left with a promise to repay.

110 Cal. App. 3d at 250, 167 Cal. Rptr. at 783.

[11]All facts in this example are from a Brief submitted to Atlanta Appeals Office, IRS, in *Estate of Hanora Dorn* on June 30, 1983, by the attorney for the Dorn Estate, Johnnie M. Walters, former Commissioner of Internal Revenue.

IRS Estate Tax Attorney sought to increase the amount of her gross estate by the sum of $139,546.76, claiming that to be the value to the bank of the use of Mrs. Dorn's money in her account over the several years prior to her death. The IRS attorney stated as follows in the Examination Report:

> Pursuant to I.R.C. Section 2035 and *Dickman v. Comm*. . . ., the value of the right to use that sum (on the part of the bank and its shareholders) is equivalent to a gift and as such must be included in decedent's gross estate under I.R.C. Section 2035.

Thus, Mrs. Dorn was deemed by the IRS in effect to have made a "gift" to an unrelated family of 73.5 percent of $139,546.76, or over $100,000, merely by keeping her money in a checking account in the only bank in her county.

Any judicial adoption of the contention of the IRS in this case inevitably would give rise to injustices and unexpected results in individual cases like that of Mrs. Dorn[12] and in a multitude of others which neither the parties nor this Court can now foresee. As stated by the Federal Circuit Court of Appeals in *Hardee*:

> **The task of fleshing out the principle, if valid, that interest-free loans are a benefit which should be taxed as income, involves the framing of meticulous and balanced rules. The judicial legislation proposed by the United States and to a less extent by the court below, would represent use of a meat axe where the appropriate instrument would be a scalpel. The authorities cited represent a so-far unanimous refusal by the judiciary to grasp the handle tendered, and we decline to break the unanimity.**
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> **708 F.2d at 667.**

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[12]The executors of the Dorn Estate, both over eighty years old, agreed to pay in settlement a portion of the tax claimed by the IRS in order to avoid protracted and costly litigation. Telephone conversation with Johnnie M. Walters, attorney for the Dorn Estate (October 10, 1983).

The IRS in its zeal again denies the need for a "scalpel" in this case, and urges this Court to do so as well. The dangers of an *ad hoc* venture into this area, however, are serious ones which cannot be dismissed in this cavalier fashion. Indeed, the experience of Great Britain with the very issue involved in this case both illustrates the difficulties of devising workable rules in this area, and demonstrates that even a careful legislative effort may well be futile, or at least productive of more difficulties than it solves.

In its Finance Act of 1975, Great Britain repealed its estate duty and replaced it with a capital transfer tax which applied to all "transfers of value" — any transfer which reduced the value of the transferor's estate — whether made during a person's lifetime or at death. Included in the capital transfers which Parliament sought to subject to tax under Section 41 of that Act were what it termed "free loans": "the use of money or other property without consideration in money or money's worth or for a consideration less than could reasonably be expected in such a transaction." Finance Act, 1975, Section 41 (see Appendix at A-1, attached). The General Notes to Section 41 recognized that this section was to have "the widest possible ambit and will cover such things as interest free loans to companies or the letting of property to a relative rent free." However, the same General Notes went on to state that "the Government has . . . undertaken to consider the effect of the section where it is considered it might operate harshly . . .", and the implementation of the new provisions was deferred for that purpose.

Before the effective date of April 6, 1976, the Government determined that more detailed provisions, which distinguished, *inter alia*, between loans which the lender could terminate at any time (demand loans) and loans which could not be terminated for a fixed or for a minimum period (term loans), were

necessary. Parliament therefore replaced Section 41 of the 1975 Act with Sections 115 and 116 of the Finance Act of 1976 (see Appendix A-2 - A-6, attached). In these detailed statutes, Parliament demonstrated its recognition of the difficulty of subjecting such "free loans" to a gift tax by providing a series of special exemptions which attempted to take into consideration the variety of possible relationships between the lender and borrower, as well as the duration of the loan. The amount of the deemed gift was also reduced by the income tax which would have been paid by the lender if the amount of the gift had been included in the lender's taxable income at the lender's highest applicable rate. Five years later, however, the experiment was a failure. In 1981, Sections 115 and 116 were repealed. The repealing statute includes the following General Note:

> The free loan provisions are abolished by this provision. There was no case where a charge had ever been made under them.

Finance Act, 1981, Section 106. (see Appendix A-6 - A-7 attached). *This statement was verified during debate on repeal: Hearings Before Standing Committee E of the House of Commons* 799-800 (1981) (see Appendix A-7 - A-9 attached).

The IRS nevertheless professes to see no potential difficulties which might be created by judicial adoption of its taxation theory in this case. For example, it claims that the practical problems of attempting to tax the multitude of instances of intra-family sharing are "largely if not entirely illusory." Brief for Respondent at 34. It seeks to demonstrate this by emphasizing the large size of a loan that would result in elimination of the entire lifetime unified gift and estate tax credit in a single year. In so doing, the IRS stubbornly refuses to acknowledge the reality that many citizens regularly have made outright annual gifts of the statutory exclusion amount, and long have acted on the

common understanding that a loan is not a "gift."[13] It is these people — or the beneficiaries of their estates upon their deaths — who would find for the first time that the long-outstanding loan to finance a son's first business endeavor or a daughter's vacation home quietly ate away the unified tax credit. It is these families who would find themselves with an unexpected tax bill, including interest on gift tax that went unpaid, and with no liquid assets to pay it.[14]

The IRS may have little concern with such practical effects of its position in this case. It has shown little concern for the fact

[13]The IRS does not deny that judicial adoption of its theory would require all citizens who make annual gifts of at least $10,000, the statutory exclusion amount, to assume the legal burden of identifying, valuing, and reporting each further loan or permissive use of property within a family, however "insignificant" in the view of the IRS.

[14]One such instance is suggested by the following example: A farmer owns farmland worth $1 million and other assets worth $500,000. He retires in 1976 but allows his grandson to farm the land thereafter, and seeks no payment from the grandson. The farmer and the grandson both understand that the farmer has the right to regain possession of the land on demand. The grandson farms the land for 20 years until the farmer dies, leaving an estate which has not changed in value. A daughter of the farmer, who has depended upon him for financial support, is his sole beneficiary.

The estate tax examiner agrees that the value of the gross estate is $1,500,000, but determines that "adjusted taxable gifts" under Section 2001(b)(1)(B) amounted to $2 million. These "gifts" are calculated by multiplying what the IRS finds to be the fair rental value of the farmland of $110,000 per year (less the $10,000 annual exclusion under Section 2503(b)) times the 20 years during which the grandson had the use of the land. As these "gifts" were unreported, a gift tax deficiency of $588,000 would be assessed and interest of $697,531.68 would be payable (ignoring the new compound interest rules of Section 6622). The resulting liability of $1,285,531.68 would be followed as a deduction under Section 2053, resulting in a taxable estate of $214,468.32 and an estate tax, after including the adjusted taxable gifts, of $105,089.51.

Under these facts, the doctrine proposed by the IRS would cause the farmer's failure to extract from his grandson cash payment for use of his land to result in a reduction of his estate from $1.5 million to a net amount of $109,378.90, after estate and gift taxes and deficiency interest — a 92.7% reduction of his gross estate. The farm would be sold to pay the taxes, but would prove insufficient; most of the farmer's other assets would have to be sold as well. His daughter, for whom he intended to provide a comfortable life, would unexpectedly be left with relatively little.

that a loan to finance a child's college tuition would be subject to gift tax under its theory, while an outright gift of the same tuition would not. See Brief for the Petitioners at 36. It also has shown that it has little concern as to whether it determines the "value" of the "right to use money" by radically different methods in the cases of different citizens, or whether retroactive imposition of gift taxes based on its theory would be unfair to many taxpayers.[18]

These are, however, precisely the types of specific considerations which would be presented to Congress in connection with its consideration of any proposed legislation in this area. More importantly, it can safely be predicted that Congress would reasonably deal with such specific issues in any law which it enacted. The reason for this is simple, and it is one which is at the heart of our Constitution's insistence that laws be made only by the Legislative Branch: the people to whom those issues matter help elect their representatives in Congress, they have access to them, and they can communicate to those representatives the concrete effects of proposed legislation upon their lives.

The IRS has avoided for years the presentation to Congress of the economic and tax policy arguments which it now asks this Court to adopt. Now — at the very time when the Treasury appears to be preparing to make that presentation — the IRS seeks a wholesale judicial adoption of its "time-value" concept by this Court, one which would impose substantial gift taxes retroactively on citizens who have made *bona fide* loans with no tax motivation whatsoever. The members of the Dickman family, for themselves and on behalf of the many affected citizens who

[18]The IRS also dismisses the problems of valuation, suggesting that they can easily be resolved "through the testimony of a banker who is familiar with prevailing interest rates." Brief for the Respondent at 37. To do so, it must simply ignore the difficulties of selecting the rates that should be applicable in an intra-family demand loan context, the disparate methods used and results reached by the IRS itself in this area, and the many difficulties of valuing permissive use within the family of property other than money.

have no voice before this Court, respectfully ask the Court to reject this request and to place this matter squarely in the legislative realm in which it belongs.

Accordingly, the judgment of the Court of Appeals should be reversed, and the judgment of the Tax Court affirmed.

Respectfully submitted,

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APPENDIX

(British Capital Transfer Tax)

Statutes are from "Finance Act 1975", "Finance Act 1976" and "Finance Act 1981", all published by Her Majesty's Stationery Office, London. The record of debate in Standing Committee E is from Hansard, the official publication of Parliamentary debates.

1975 ACT:

Free loans etc.

41.—(1) Where a person, otherwise than in a transaction at arm's length between persons not connected with each other, allows another the use of money or other property without consideration in money or money's worth or for a consideration less than could reasonably be expected in such a transaction, he shall be treated as making a transfer of value in every chargeable period in which he allows that use; and—

(a) the value transferred thereby shall be the difference between the amount of the consideration (if any) for that period and that of the consideration that might be so expected; and
(b) the transfer shall be treated as being made at the end of the chargeable period or, if earlier, at the time when that use comes to an end; and
(c) the transfer shall be treated as made out of the transferor's income.

(2) In this section "chargeable period," in relation to any use, means the period beginning when the use is begun and ending with 5th April next following, and every subsequent period of twelve months ending with 5th April, but no period beginning before 6th April 1976 shall be a chargeable period.

General Note

This section creates a transfer of value when assets are made available to a person when that person does not pay the market price for their use. The section has the widest possible ambit and will cover such things as interest free loans to companies or the letting of property to a relative rent free. The Government has however undertaken to consider the effect of the section where it is considered it might operate harshly, *e.g.* loans to companies, or by one partner to another (see Hansard, Vol. 887, 1944). This is why the coming into effect of the section is postponed until April 6, 1976.

Note that the transfer is treated as made out of the transferor's income thus enabling the exemption in Sched. 5, para. 5 to be obtained in appropriate circumstances. This paragraph would be less likely to provide exemption if the interest fee loan etc. were made for only one year than if it were made for a number of years.

1976 ACT: *Loans*

Free loans etc.

115.—(1) Where an individual ("the lender") allows another person ("the borrower") the use of money or other property in any year, then, subject to the provisions of this section and section 116 below, the lender shall be treated as making a disposition as a result of which the value of his estate is reduced by the amount (if any) by which any consideration for the use falls short of the cost to him of allowing it (determined in accordance with section 116 below).

(2) The disposition under subsection (1) above shall be treated as made at the end of the year or, if earlier, at the time when the use comes to an end.

(3) Where the use of the property is allowed for a period specified in advance, or where in any other case the lender has no right to terminate the use immediately after it begins, subsection (1) above shall not apply in relation to use before the expiration of the specified period or, as the case may be, before the earliest time when the lender could terminate the use if he exercised his right to do so at the earliest opportunity.

(4) Subsection (1) above shall not apply in relation to any use of property allowed to the borrower at a time when it is mainly used by the lender or the lender's spouse.

(5) Subsection (1) above shall not apply in relation to the use of property for a period which is less than twelve months unless that period falls within a period of twenty-four months during which the lender allows the borrower the use of that property or similar property for periods which amount in aggregate to twelve months or more; and in calculating that aggregate no account shall be taken of—

(a) use to which, by virtue of subsection (3) or (4) above, subsection (1) does not apply, or

(b) use to which (apart from this subsection) subsection (1) above does apply, if the disposition under that subsection is not a transfer of value.

(6) Subsection (1) above shall not apply in relation to the use of property where the borrower is a body corporate if—

(a) it is not a close company; or
(b) not less than 90 per cent in nominal value of its issued ordinary shares are shares to which the lender or his spouse is beneficially entitled; or
(c) it is not an investment company and either—

(i) the lender or his spouse is a participator in the company or its holding company or has been such a participator at any time during the year or either of the two preceding years; or

(ii) the lender's spouse died during the year or either of the two preceding years and was at any time during the three years ending with the year in which he died a participator in the company or its holding company.

(7) Subsection (1) above shall not apply in relation to the use of property where the borrower is a firm if—

(a) the lender or his spouse is a partner or has been a partner at any time during the year or either of the two preceding years; or
(b) the lender's spouse died during the year or either of the two preceding years and was a partner at any time during the three years ending with the year in which he died.

(8) Subsection (1) above shall not apply in relation to a loan in respect of which any person is chargeable to income tax under Schedule E by virtue of section 66 (1) above.

(9) For the purposes of this section an individual who makes a revocable gift of any property to another person shall, so long as the gift continues revocable, be taken to allow him the use of that property.

(10) In this section—

"close company" and "participator" have the same

meanings as in section 39 of the Finance Act 1975;
"firm" has the same meaning as in the Partnership Act 1890;
"holding company" has the same meaning as in section 154 of the Companies Act 1948;
"investment company" means a company falling within paragraph (a) of paragraph 16 (3) of Schedule 4 to the Finance Act 1975 and not falling also within paragraph (b) or (c) of that paragraph;
"ordinary shares" has the same meaning as in paragraph 13 of that Schedule;
"year" means period of twelve months beginning with 6th April.

(11) This section has effect, in place of section 41 of the Finance Act 1975, in relation to the year beginning 6th April 1976 and subsequent years.

General Note

This provision imposes a charge to c.t.t. upon the cost to a lender of making his property available free of charge to a borrower. This wholly replaces F.A. 1975, s. 41, which never took effect, so that "loans" are only chargeable to c.t.t. after April 5, 1976.

For a charge to arise under this provision the following conditions must be satisfied, namely:

(i) The loan must be made by an individual—so that a loan by a company or trust will not be caught by this charging provision.

(ii) That individual must allow another person (so this may include a company or trustees) the use of his money or property whilst retaining a right to recover that money or property. The loan of the money or property for a fixed period thereby giving the borrower a right to retain it as against the lender will not come within s. 115 until the earliest time at which the lender could have recovered the money or property either through the expiry of time or the exercise of a right. Such a loan for a fixed period, or subject to the exercise of a notice of revocation, will, however, be chargeable as a transfer of value under F.A. 1975, s. 20. It should be noted that a revocable gift will be treated as the loan of money or property for these purposes.

(iii) The loan of money on property is not one of the following:

(a) exempt under one of the general exemptions, *e.g.* normal expenditure exemption applied by virtue of s. 117 of this Act (see below);
(b) made to a borrower but used "mainly" by the lender or lender's spouse;
(c) made to a public company;
(d) made to a close company in which the lender or the lender's spouse holds, beneficially, not less than 90 per cent, in nominal value of its issued ordinary shares;
(e) made to a close company which is not an investment company and

in which company (or the holding company) the lender is, or was at any time in the year in respect of which the charge arises or the preceding two years, a participator. Alternatively, this will equally apply if instead of the lender it is the lender's spouse that is the participator in the same circumstances or if the spouse has died during that two year period was a participator at any time during the three years ending with the year in which the spouse died;

(f) made to a firm (defined by the Partnership Act 1890, s. 4) in which the lender or lender's spouse is, or was at any time as specified in (e) above, a partner;

(g) a loan resulting in any person being chargeable to income tax under Schedule E by reason of s. 66 (1) of this Act (see above).

When a loan of money on property has been made which satisfies these requirements then a disposition is treated as having been made either at the end of the year (April 5) or at the time when the use came to an end during the year, whichever is appropriate. The reduction in the lender's estate is taken to be the difference between the consideration given by the borrower and the cost of the loan to the lender determined in accordance with s. 116.

Free loans etc.: value transferred

116.—(1) The cost to the lender of allowing the use of money or land shall be taken to be equal to the consideration which might be expected in a transaction on the same terms as those on which the use is allowed (apart from terms as to consideration) made at arm's length between persons not connected with each other.

(2) The cost to the lender of allowing the use of property other than money or land shall be taken to be equal to the aggregate of—

(a) the annual value of the use of the property or, if the use does not continue throughout the year, a proportionate part of that annual value, and

(b) any expense incurred by the lender in connection with property during the year or, if the use does not continue throughout the year, a proportionate part of that expense, but excluding expense incurred in the acquisition or production of the property and excluding any hire charges;

except that if the property is hired by the lender and the annual amount of the hire charges is greater than the annual value of the use of the property, paragraph (a) above shall have effect as

if it referred to that annual amount instead of to that annual value.

(3) If the property is money or land, the amount arrived at under section 115 (1) above shall be reduced by the income tax which would be chargeable in respect of that amount (after taking account in the case of land of any deductions which might be made for the purposes of Schedule A) if it were the highest part of the lender's total income; and in calculating that income there shall be disregarded any such sum as is mentioned in paragraphs (a) to (c) of section 529 of the Taxes Act.

General Note

The amount on which a charge under s. 115 is made will be in the case of land and money the income forgone by the lender net of income tax at the lender's top marginal rate. In the case of other property, principally wasting assets, the amount will be the annual value of the property (*i.e.* its depreciation) plus any expenses on the property borne by the lender.

Subss. (1) *and* (3). These deal with the loan of money or land. The amount upon which the c.t.t. charge is made will be the consideration that would have been received from an arrangement for such use made between unconnected persons at arm's length reduced by the consideration actually received by the lender. There is a further reduction of the income tax that would have been paid by the lender had he received the full consideration and treating this as the highest part of the lender's income. The following payments are to be disregarded when determining the lender's liability to income tax, that is, (a) any payments received upon retirement or the removal from an office or employment and assessable under I.C.T.A. 1970, s. 187; (b) any gains from insurance policies assessable under I.C.T.A. 1970, s. 399; (c) any sum chargeable under I.C.T.A. 1970, Sched. 3, para. 2 (such as premiums on lease and payments concerning sale of land with right to reconveyance).

Subs. (2). This concerns the loan of property other than money or land. In such a case the amount chargeable is the sum of the annual value of the property and any expenses incurred by the lender in respect of the property (disregarding the expenses of purchasing, manufacturing or hiring the property).

The cost to the lender of hiring the property will be substituted for the annual value of the property if that cost is greater than the property's annual value.

1981 ACT:

Free loans

106.—(1) Sections 115 and 116 of the Finance Act 1976 (free loans etc.) shall cease to have effect.

(2) This section applies where the disposition under subsection (1) of section 115 would in accordance with subsection (2) of that section be treated as made on or after 6th April 1981.

General Note

The free loan provisions are abolished by this provision, there was no case where a charge had ever been made under them.

Clause 100

Free loans (Debate - Standing Committee E)

Question proposed. That the clause stand part of the Bill.

Mr. Robert Sheldon: The clause covers the free loans provision. Under the existing legislation, capital transfer tax was charged essentially on the benefits of those interests that were concerned. Clearly, a loan certainly confers a very large advantage on its beneficiary. It is, in effect, a transfer of capital. If one person gives another the use of a substantial sum for a period of years, he is, in effect, making a transfer of money from himself to the beneficiary—from the donor to the donee—and it is right that capital transfer tax be charged on it.

This is a relieving provision which says that for some reason capital transfer tax will not be charged on this transfer of what is, in effect, money passing from one person to another. I would like to hear the honourable and learned Gentleman's justification. I know that the amounts of revenue are not likely to be large, but I should be obliged if the honourable and learned Gentleman would give me an illustration or assessment of this. I do not see why, for the reasons that I have given on many other clauses, this particular relieving provision should be in a Bill which places so many burdens of the kind that we have already discussed.

Mr. Peter Rees: It is almost with a sense of nostalgia that I rise to respond to the right honourable Gentleman. It carries me, as it no doubt carries him, back to the debates we had in this same Committee Room some six years ago. He will remember that, as capital transfer tax was first devised, there was to be a blanket charge to capital transfer tax for free loans. Then a

wealth of instances was brought to his and his right honourable Friend's, attention by my hon. Friends and even perhaps myself, showing how hard this would bear on people, particularly in the business sector.

It was in a gracious response to those arguments that sections 115 and 116 were introduced. Though they perpetuated the charge for free loans—the loans had hardly been introduced so perhaps "perpetuated" is a slightly maladroit description—none the less they hedged it round with considerable exemption. For instance, there was an exemption for any period during which the property concerned was mainly used by the lender or his spouse. Secondly, loans where the property or similar property was made available for fewer than 12 months within a 24-month period were exempted. Thirdly, certain loans to companies and partnerships had particular importance for exemption, and finally, loans which were chargeable to income tax under schedule E were exempted.

I am happy to pay tribute, over the years, to the open-mindedness of the right honourable Gentleman and his right honourable Friend's on that occasion. The exemptions were worked into what was otherwise a rather unattractive piece of legislation.

The consequence of this is that in practice the free loan provisions have never had to be invoked by the capital taxes office. We felt that perhaps they were otiose, spent, and were no longer serving a useful purpose. They were of some complication and might have involved some administrative trouble, both for personal representatives or trustees or for the Inland Revenue. Therefore, we felt that they could be legitimately swept off the statute book. I am happy to reassure the right honourable Gentleman that, on the past experience of the capital taxes office, there will be a negligible loss of revenue.

I hope that the right honourable Gentleman, looking back with me with nostalgia to our previous debates, will feel that perhaps these sections can now be swept away.

Mr. Robert Sheldon: The Minister of State says that the

provisions were never invoked. Does he mean by that that there has never been a case where a charge has been made here?

Mr. Rees: So I am credibly informed.

Finally, let me reassure the right honourable Gentleman that the asset that may or may not be loaned will, by definition, remain the property of the transferor and so ought to be swept up in a charge to capital transfer tax on his death or on any subsequent transfer. Therefore, I hope that the right honourable Gentleman will be reasonably reassured by what I have said and that the Committee will feel able to support the clause.

Question put and agreed to.

Clause 100 ordered to stand part of the Bill.

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No. 82-1041

In the Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND ESTATE OF PAUL B. DICKMAN, DECEASED, G. WENDELL SMITH, PERSONAL REPRESENTATIVE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF OF AMICUS CURIAE, D'ANCONA & PFLAUM, IN SUPPORT OF PETITIONERS

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No. 82-1941

In the Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND ESTATE OF PAUL B. DICKMAN, DECEASED, G. WENDELL SMITH, PERSONAL REPRESENTATIVE,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF OF AMICUS CURIAE, D'ANCONA & PFLAUM, IN SUPPORT OF PETITIONERS

INTEREST OF AMICUS CURIAE

Amicus curiae, D'Ancona & Pflaum, is a law firm with its principal office in Chicago, Illinois. A number of its clients are interested in the outcome of this proceeding because they are in a position substantially identical to that of the petitioners. Included among these clients are many who reside in the area encompassed by the Seventh Circuit and who relied on a prior decision by the Seventh Circuit which is contrary to the decision in this case by the Eleventh Circuit.

Both parties have consented to the filing of this brief, and their consents have been filed with the Clerk of this Court.

SUMMARY OF ARGUMENT

The Eleventh Circuit incorrectly decided that interest-free loans, repayable on demand, from parents to their son and a closely held corporation controlled by the lenders and their children, constitute taxable gifts, and improperly rejected prior holdings to the contrary by the Seventh Circuit, the Tax Court, and a district court.

The *Crown*[1] decision by the Seventh Circuit in 1978 wisely avoided two severe morasses which would be created by this Court's affirmance of the decision of the Eleventh Circuit:

(1) An unprecedented retroactivity because of the unique nature of limitations applicable to the gift tax and the nationwide scope of individual loans made in reliance on the *Crown* decision; and

(2) An unconscionable burden on the courts if they had to deal with the especially complex issue of determining appropriate interest rates on a case-by-case, and on a daily, basis.

If the Commissioner's position in this case is sustained, he will be free to assert gift tax deficiencies against most taxpayers who made interest-free loans at any time since the inception of the gift tax in 1932.

While the valuation issue is not technically before this Court, the method used by the Commissioner demonstrates why the imposition of a gift tax, if any, as a result of an interest-free demand loan, is appropriate only for congressional action. Here, the Commissioner has asserted interest rates which are (a) inconsistent with his only public announcement on the subject; (b) inconsistent with his inconsistent positions in the three other cases where he has raised the issue; (c) inconsistent with the rate he has established by regulation to be charged on loans between related business

[1] *Crown v. Commissioner*, 585 F.2d 234 (7th Cir. 1978), *aff'g* 67 T.C. 1060 (1977). The *amicus curiae* herein represented the taxpayer in that case.

entities for income tax purposes; and (d) in fact, a rate which would have been usurious under most state laws.

The decision of the Eleventh Circuit should be reversed.

ARGUMENT

I.

THE SCOPE OF RETROACTIVITY

A judicial decision creating imputed interest on demand loans is necessarily retroactive in effect, in contrast with legislative action which would only be prospective.

A. Limitations Applicable to the Gift Tax

Because of the unique limitations provisions of the gift tax laws, affirmance of the decision below may apply to gift tax periods all the way back to 1932.

(1) No gift tax limitations apply to any period for which no gift tax return was filed.[2] Few people file gift tax returns every year. Thus, for each year for which no gift tax return was filed, there is no limitations period.

Even more to the point, for the 40 calendar quarters between 1971 and 1981 (when quarterly, rather than annual, returns were required), it is extremely unlikely that any taxpayer filed a gift tax return every quarter. And each quarter for which no return was filed is open to retroactive assessment.

(2) Even as applied to periods for which a gift tax return was filed for other gifts, the usual 3-year limitations period does not apply and a 6-year limitations period applies if the imputed interest on the loan is more than 25% of the reported gifts.[3]

Six years have not yet expired since loans were made in reliance on the *Crown* decision in 1978.

(3) Even where a gift tax return was filed and the 6-year or 3-year limitations period has run, an unreported gift could still result in a higher tax in a subsequent year

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[2]I.R.C § 6501(c)(3).

[3]I.R.C. §§ 6501(e)(2) and 6501(a).

through the inclusion of the amount of the earlier year's gift in determining the tax bracket applicable to the subsequent gift.[4] This effect derives from the fact that the gift tax from 1932 to 1976 was cumulative, so that the tax paid for any period was computed by determining the tax based on all taxable gifts since 1932 and then subtracting the tax based on the taxable gifts for all prior periods.[5] This cumulative effect is now computed differently but continued under the unified rate schedule for gift and estate tax since 1976.[6]

B. Factual Background for a Retroactive Decision

Prior to the *Johnson*[7] decision in 1966, there were no court decisions or Internal Revenue Service rulings or regulations seeking to treat the making of a low- or no-interest demand loan as a gift. The Service's effort in the *Johnson* case was unsuccessful.

Only in 1973, while the *Crown* case was in process, did the Commissioner issue his non-acquiescence with *Johnson* and assert such a position as a general rule.[8] This position was expressly rejected by the Tax Court in *Crown* at the trial level in 1977,[9] and the rejection was sustained by the Seventh Circuit on appeal in 1978. The Commissioner did not seek *certiorari* in *Crown*, nor has he made any effort by proposed regulation or legislative proposal since *Crown* to reverse the effect of that decision.

Even in the massive changes of the gift tax law enacted by Congress in 1976 and 1981, no effort was made and no reported consideration was given to changing the rule laid down in *Crown*.

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[4]See *Daanen* v. *Commissioner*, 30 T.C.M. (CCH) 286, 294 (1971).

[5]I.R.C. §§ 2502, 2504 (Pre-1977).

[6]I.R.C. §§ 2502, 2504 (Post-1976).

[7]*Johnson* v. *United States*, 254 F. Supp 73 (N.D. Tex. 1966).

[8]Rev. Rul. 73-61, 1973-1 C.B. 408.

[9]*Crown* v. *Commissioner*, 67 T.C. 1060 (1977), *aff'd*, 585 F.2d 234 (7th Cir. 1978).

However, since the 1977 and 1978 court decisions in *Crown*, hundreds of articles on interest-free demand loans have been published; every financial newsletter has recommended such loans; and banks throughout the country have actively promoted such loans between family members. As a result, in reliance on those decisions, it is an established fact that thousands and thousands of interest-free demand loans have been made, the practice becoming so widespread that the appellation "Crown loan" is commonplace in financial circles. (For the reasons and in the manner set forth in III C below, Congress can deal appropriately with whatever it may consider abuses involved in the promotion of interest-free loans.)

Thus, a retroactively effective decision by this Court, coupled with the open limitations periods unique to the gift tax, could result in an enormous number of tax assessments for past periods on taxpayers who relied in good faith on advice based on the *Crown* decision.

II.

DETERMINATION OF THE INTEREST RATE TO BE IMPUTED IN OPEN YEARS WOULD PLACE AN UNCONSCIONABLE BURDEN ON THE COURT SYSTEM

For all such taxpayers for all open years, the volume of back assessments could reasonably be expected to be very large. In each such case, the factual issue to be determined will be different from every other case. Where a low- or no-interest demand loan was made, if a gift at all, the gift would be that amount of interest which represents the fair market value of the use of the money loaned to the particular borrower which in turn, might depend upon such factors as the prevailing interest rate in the area, his creditworthiness, the purpose of the loan, the security for the loan, and whatever else the Commissioner or the taxpayer considered relevant.

The Commissioner recognized the problem of making such a determination in the present case by ignoring the fair market value of money to the particular borrower and asserting instead the statutory interest rate from time to time applicable to tax deficiencies.[10] The court below in this case avoided the issue by remanding the case to the Tax Court to determine applicable interest, thereby rejecting this approach of the Commissioner.

A. The Commissioner has Asserted Inconsistent Positions

In *Johnson*, the Commissioner proposed a 3½% rate—the rate then by regulatory table applicable to the valuation of future interests[11]—for valuing the interest-free use of loaned funds repayable on demand.

In *Crown*, the Commissioner claimed a 6% rate for valuing the demand loans, as more or less representing the then effective "prime rate."[12]

In Rev. Rul. 73-61, the Commissioner asserted an otherwise unspecified "value of the use of the money" for demand loans, and the future interest valuation table for valuing the interest-free use of loaned funds repayable at the end of a specified term (then and now, 6%).[13]

In this case, the Commissioner applied the statutory tax deficiency interest provisions to the demand loan (ranging from 6% to 9% for the periods involved, and up to 20% since), and the 6% future interest valuation table to the alleged term loan.[14]

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[10]I.R.C. § 6621. This rate is now adjusted each January 1 and July 1, based on the average prime rate during the 6-month period ending on the preceding September 30 and March 31, respectively, rounded to the nearest full percent.

[11]Treas. Reg. § 25.2512-5(f).

[12]See 67 T.C. at 1061.

[13]Treas. Reg. § 25.2512-9(f).

[14]41 T.C.M. (CCH) 620, 622-623 (1980).

In *La Rosa*, now pending in the Tax Court, the Commissioner is asserting rates from 23.08% to 31.10% for 1979 on demand loans—twice the prime rate—and rates from 12.5% to 23.1% for the preceding 5 years. These were "obtained by consulting with an expert witness," to quote the Answer filed by the Commissioner.[15]

B. "Fair" Imputed Interest is an Extremely Complex Factual Issue

First, the case-by-case determination of how much interest is to be imputed on a particular loan over a particular period is a valuation issue. Like all valuation issues, the decision depends on the facts of each case.

Although much information is available about all kinds of commercial interest rates, the facts necessary to value the right to use money on a day-by-day basis are unique to each case.

Also, it is increasingly well-established that "prime rate" is an artificial concept, not applicable even in most commercial lending situations. At its origin in 1933, the prime rate was the interest rate that a bank charged its most creditworthy customers for short-term loans.

By 1980, the making of below-prime rate loans had become so widespread that Congressman Reuss, Chairman of the House banking committee, requested Chairman Volcker of the Federal Reserve to make "an investigation and report concerning this entire situation," noting that "large corporate borrowers were obtaining loans as much as 6 percent under the prime rate."[16] The staff report submitted in response by Chairman Volcker confirmed the practice of

[15] *LaRosa* v. *Commissioner*, No. 29632-82 (T.C., pet. filed Dec. 22, 1982, ans. filed Feb. 28, 1983).

[16] *Conduct of Monetary Policy, Hearing before the House Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 2nd Sess. 157 (Ser. no. 63, 1980).

below-prime lending by banks to both large and small borrowers.[17]

The following year, the Federal Reserve reported to the committee that during May, 1980, 60.7% of the commercial loans made by large New York banks were below the publicly announced prime rate, and that the average discount from prime was 4.26 percentage points.[18] The staff of the committee conducted an analysis of the loans made by the nation's ten largest banks and found that the prime rate had become "a murky, ill-defined term that rarely reflects the lowest rates available to corporate customers" and that "its meaning [had become] virtually destroyed by the various discounts employed secretly by much of the banking industry."[19]

The latest information available from the Federal Reserve shows that during the first week of November, 1982, 92.2% (in dollar amount) of all short-term commercial and industrial loans made by large banks were made at below-prime rates.[20] Nevertheless, banks have persisted in quoting an artificially high prime rate because of the potential loss of revenue from outstanding long-term loans which are at rates tied to prime.[21]

With the burden on the taxpayer to dispute the Commissioner's rates claimed in his deficiency notice, those taxpayers who could afford the cost of litigation would introduce a

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[17]*Id.* at 132-156.

[18]Staff of House Comm. on Banking, Finance and Urban Affairs, 97th Cong., 1st Sess. *An Analysis of Prime Rate Lending Practices at the Ten Largest United States Banks* 2 (Comm. Print 1981).

[19]*Id.* at 3 and 20.

[20]Board of Governors of the Federal Reserve System, *Survey of Terms of Bank Lending.* This survey is made regularly for the first week of the second month of each calendar quarter.

[21]Merris, *Prime Rate Updated,* Economic Perspectives 14 (Fed. Res. Bk. of Chgo., May/June 1978).

series of expert witnesses on actual lending rates used for individual loans by banks and others. The Commissioner would then have to meet this testimony with that of other experts, and a classic pattern of case-by-case valuation would be presented.

Here, however, the problem will be intensified. Imputed interest on demand loans cannot be figured on a single date like most valuation cases; *i.e.*, the date of death or the date of the gift. Rather, since the gift is alleged to occur each day repayment is not demanded, valuation must be a continuous determination over all the days, months and years the loan was outstanding. Even the announced "prime rate" frequently changes weekly;[22] testimony as to changes throughout the applicable period would be unconscionably detailed and complex.

The Tax Court is already concerned with the burden of valuation cases, as distinquished from interpreting or analyzing the tax laws. This is stated in many Tax Court opinions, but most effectively in *Buffalo Tool*[23] where the Tax Court said:

> "[W]e are left with only the pure factual issue, the value of each item of machinery as of March 21, 1973. As the Court repeatedly admonished counsel at trial, the issue is more properly suited for the give and take of the settlement process than adjudication. See *Messing* v. *Commissioner*, 48 T.C. at 512. The existing record reeks of stubbornness rather than flexibility on the part of both parties, based upon 'an overzealous effort *** to infuse a talismanic precision' into their respective views as to valuation. See *Messing* v. *Commissioner*, 48 T.C. at 512. We are convinced that the valuation issue is capable of resolution by the parties themselves through an agreement

[22]The prime rate changed 39 times during 1980. Board of Governors of the Federal Reserve System, *Annual Statistical Digest 1980* 75 (1981).

[23]*Buffalo Tool & Die Manufacturing Co.* v. *Commissioner*, 74 T.C. 441, 451-452 (1980).

which will reflect a compromise Solomon-like adjustment, thereby saving the expenditure of time, effort, and money by the parties and the Court—a process not likely to produce a better result . . . . If the parties insist on our valuing any or all of the assets, we will. We do not intend to avoid our responsibilities but instead seek to administer to them more efficiently—a factor which has become increasingly important in light of the constantly expanding workload of the Court."

This attitude was repeated in *Simmonds*[24] in 1980 where the Tax Court said:

"The valuation process is already a difficult and time-consuming drain on the Court's resources . . . ."

III.

CONSIDERATIONS TO BE WEIGHED BY CONGRESS

As stated earlier, for the past 5 years the Commissioner has made no effort to present these issues to Congress even though both the *Crown* and *Johnson* courts determined that this was the only appropriate resolution of the question. Rather, the Commissioner has continued his "back door" approach of seeking judicial legislation after 50 years of the gift tax in which demand loans at low- or no-interest were not treated as taxable gifts.

A. "Fair" Imputed Interest is a "Catch-22" Under State Usury Laws

If the present case is affirmed, a taxpayer making a demand loan and wishing to charge interest to avoid making a gift is in an untenable position. If he charges a "market-type" rate of interest, he violates the usury laws of most states; if he observes the usury laws, he has made a taxable gift.

This is not a business or commercial loan question. Business transactions are a long-established exception from

[24] *Simmonds Precision Products, Inc.* v. *Commissioner*, 75 T.C. 103, 123 (1980).

the scope of the gift tax and of most usury laws. Nor is this a problem of loans from controlled corporations to shareholders or executives. These the Internal Revenue Service seeks to reach through the income tax, albeit unsuccessfully (*Dean*[25] and its progeny).

Rather, loans at low- or no-interest occur only between people with a personal relationship, usually within a family. All three recorded cases are intra-family and, in reality, only within a family would such loans be made.

While state usury laws have been changed to keep pace with commercial interest rates, by and large the state usury rates applicable to non-business, individual loans still are considerably below any possible fair market value of the use of money. This appears to be true of most of the 50 states and specifically is true in the more commercially-active states of New York, California, Illinois, Michigan, Pennsylvania and Florida, and the District of Columbia.

Furthermore, since such a large past period is open for assessment, even such changes in the usury laws as may be applicable have consistently lagged far behind interest rates in the market place.

Congress alone has the power to supersede state usury laws if it deemed this issue sufficiently important to exercise this power.[26]

B. Whether to Impute Interest on Intra-family Loans is a Question of Public Policy

The Commissioner argues that a taxable event occurs whenever one member of a family loans money to another family member without charging a full economic price. The same principle would apply to a loan of anything of value.

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[25]*Dean* v. *Commissioner*, 35 T.C. 1083 (1961), *nonacq.*, 1973-2 C.B.4.

[26]Congress, for example, preempted state usury laws on certain business and agricultural loans made between April 1, 1980 and April 1, 1983 (Sections 511 and 512 of the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C.S. §§ 86a, 86a note (Law Coop. supp. 1982)).

If his position is sustained by this Court, the decision will make the existing gift tax law applicable to all intra-family "loan" or "free use" arrangements. This would automatically extend to the use of houses, apartments, cars, boats, among other things. Even the guarantee of a child's debt to enable him to obtain an advanced education or get started in business would be a taxable gift unless an appropriate fee for the use of the parent's credit were charged.

As applied to money, Congress may well conclude that an intra-family loan should not be required to take on the aspects of a commercial transaction. In fact, many family loans arise because the borrower (brother-in-law or child) is not sufficiently credit-worthy to borrow commercially (and in such case the imputed interest rate on a market value basis could easily be 50%). Indeed, the moral question goes all the way back to biblical days. *Deuteronomy*, Chapter XXIII, verse 20 states:

> "Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury . . . ."
>
> (In biblical research it is well-established that the word "usury" means any interest, not just excessive interest.)

C. Any Action by Congress Can be Selective; Judicial Action Cannot

Congress has previously faced the problem of legislating to create imputed interest.

After the Commissioner lost in his effort to obtain a court decision that interest should be imputed in installment sale situations,[27] Congress considered the matter and enacted Code Section 483. This section established a number of statutory exceptions from the new rules, reflecting congressional policy judgments as to the desirable scope of imputing interest in that area. Similarly, Congress may establish rules of inclusion and exclusion crafted to balance the competing goals of family integrity and the gift tax. In particular,

[27] *Brown* v. *Commissioner*, 37 T.C. 461 (1961), *aff'd*, 325 F. 2d 313 (9th Cir. 1963), *aff'd*, 380 U.S. 563 (1965).

Congress could specifically provide that if no-interest demand loans are made with commercially-borrowed funds, the lender will lose his interest deduction. This would be similar to the rule already established where loans at interest are made to acquire tax-exempt securities.[28] Indeed, even in the area of interest-free demand loans, this result is indicated in *Creel*,[29] one of the *Dean* line of cases.

D. Congressional Action Can Eliminate the Valuation Issue

When Congress enacted Section 483, it required the Commissioner to establish by regulation the interest rate to be imputed if inadequate interest was provided in the installment sale contract. Although the Commissioner can amend (and has amended) the regulation to change the stipulated rate prospectively from time to time, every taxpayer can readily follow the regulatory provisions and thereby eliminate any uncertainty as to what rate of interest should be imputed.

Again, when Congress was considering what interest might be imputed under Section 482 in transactions between related business entities, it used its authority to postpone action by the Commissioner over a 7-year period while the Commissioner evolved "safe-harbor" rules similar to those adopted under Section 483.

In both of these instances, the fixing of applicable rates of imputed interest eliminated the entire "valuation" problem and thus avoided the evidentiary morass inherent in judicial determination of applicable interest rates on a case-by-case, daily, basis.

Even more significant, our taxing system—which is the most successful system in the world in relying on self-

[28] I.R.C. § 265.

[29] *Creel* v. *Commissioner*, 72 T.C. 1173, 1179-1180 (1979), *aff'd sub nom. Martin* v. *Commissioner*, 649 F.2d 1133 (5th Cir. 1981).

assessment—can function properly only when the taxpayer can know and rely on the clarity of his obligations.[30] The practical effect of the decision below is thus unworkable and unfair.

CONCLUSION

It is respectfully submitted that the decision of the Court of Appeals below should be reversed, the action of the Tax Court in this case affirmed, and the issue left to appropriate congressional consideration.

Respectfully submitted,

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[30]If this Court should conclude that the holding of the Eleventh Circuit was correct, in view of the fact that thousands of taxpayers in the Seventh Circuit have made low- or no-interest loans in reliance on the *Crown* case, this Court's decision should be applied prospectively in the Seventh Circuit. See *Diedrich* v. *Commissioner*, 457 U.S. 191, ___ n. 10 (1982).

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No. 82-1041

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

ESTHER C. DICKMAN AND ESTATE OF PAUL B. DICKMAN, Deceased, G. WENDELL SMITH, Personal Representative,
Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Brief Of Amicus Curiae Jones, Day, Reavis & Pogue In Support Of Petitioners

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QUESTION PRESENTED

Whether forbearance to demand repayment of an interest-free demand loan constitutes a gift for tax purposes.

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INTEREST OF AMICUS CURIAE

Jones, Day, Reavis & Pogue is a law firm with principal offices in Cleveland, Columbus, Dallas, Los Angeles, and Washington, D.C. A number of its clients are interested in the outcome of this case, because they are in a position substantially identical to that of the petitioners. The tax liability of these clients will be directly affected if the decision below is affirmed.

Consent to file this brief from counsel for both sides has been filed with the Clerk of this Court.

STATEMENT

In this case the Commissioner seeks to expand section 2501(a)(1) of the Internal Revenue Code to permit the finding of a "deemed" or "constructive" gift, subject to tax, when a person lends money to another on an interest-free demand basis. The purported gift is not of the principal of the loan, but of the forbearance, without interest, in demanding repayment. It is said that such forbearance fits within the general language of section 2501(a)(1), which imposes a gift tax on a "transfer of property by gift." No question is raised in this case as to the power of Congress to impose a tax in such a situation, by the enactment of specific language making its intention clear.

The Commissioner's arguments, summarized, are: that section 2501(a)(1) has been read broadly before, and should be so read here to encompass the Commissioner's "forbearance" theory; that fifty years of contrary history, administrative and judicial, is irrelevant; and that the Commissioner's "forbearance" theory, including the many technical problems it presents, is best worked out through the courts, with no further legislation required.

The Decisions Below

The Tax Court below held that no gift tax consequences resulted from an interest-free demand loan. *Dickman v. Commissioner*, 41 T.C.M. (CCH) 620 (1980). The Court of Appeals for the Eleventh Circuit reversed. 690 F.2d 812 (1982).

The Tax Court below relied on the decision of the district court in *Johnson v. United States*, 254 F. Supp. 73 (N.D. Tex. 1966), and its own decision, reviewed by the full Tax Court and affirmed by the Court of Appeals for the Seventh Circuit, in *Crown v. Commissioner*, 67 T.C. 1060 (1977), *aff'd*, 585 F.2d 234 (1978). These were the only two cases which had previously considered the issue. The Tax Court held in *Crown* that

"[t]he Courts have uniformly rejected every attempt by the Internal Revenue Service to subject the making of non-interest bearing loans to income or gift tax consequences . . . [and] if the scope of the gift tax law is to be expanded to encompass such permissive use, we think it should come through congressional action, and not through unnecessarily broad judicial interpretation." 67 T.C. 1060, 1064-65. The court of appeals in *Crown* held similarly, explaining that the Commissioner's theory implied "a broader concept of what constitutes a property right under the gift tax laws than has heretofore been recognized." 585 F.2d 234, 240.

The court of appeals in *Dickman*, relying on the "clear, sweeping intent" of the gift tax laws, and on cases involving cash or other property loaned not on demand but for a term, disagreed with *Johnson* and *Crown* and held that forbearance to demand repayment on an interest-free demand loan constituted a transfer of property by gift. The court of appeals remanded, however, to calculate the value of this purported "property transfer."

SUMMARY OF ARGUMENT

1. It is uncontroverted that the terms "gift" and "property" have been given a broad reading for gift tax purposes. This is comparable to the broad reading given the term "income" for income tax purposes. Despite these broad readings, the Commissioner made no argument that an interest-free demand loan could result in the receipt of income or a gift for several decades after the passage of the income and gift tax laws, respectively. Nor, despite these broad readings, had any court so held until the decision below.

This issue has been extensively litigated in the income tax area.[1] In each instance, the Commissioner has been told that his theory, although arguably encompassed by the broad reading given to "income," should be pursued in Congress. The

[1] The leading case is *Dean v. Commissioner*, 35 T.C. 1083 (1961). Nine other cases upholding *Dean* are discussed below.

Commissioner was similarly instructed in *Johnson* and *Crown*. These decisions are grounded as much in the belief of the courts involved that they *should not* interpret the tax laws as expansively as required to encompass the Commissioner's theory, as they are in the belief that the tax laws *cannot* fairly be so read. The decision below should not be affirmed, therefore, not only because this would require resolution of the very difficult issue as to whether the tax laws *can* fairly be so read, but because it would contradict the almost universal advice of the courts that they *should not* be. In application of the principle that taxes should be imposed by Congress, and not by expansive judicial interpretation, this Court should uphold the Tax Court and the reasonable expectations of taxpayers, and require the Commissioner to seek the authorization of Congress before pursuing his theory.

2. Without specific congressional authority, the efforts of the Commissioner to impose tax consequences in other circumstances involving the absence of a stated interest charge—for example, in installment sales or dealings between related corporations—have been consistently rejected. This has followed from the realization of the courts that Congress has been both specific and articulate when it intended interest to be taken into account for tax purposes. To this end, the Internal Revenue Code contains numerous provisions setting forth the particular circumstances requiring interest and the exact rates to be used. Moreover, where the Commissioner has gone to Congress and explained a potential abuse arising from the failure to provide for interest in a particular circumstance, congressional action has often followed—and the courts have thereafter had clear rules with which to work. But in the absence of such authority, the courts have not deemed it prudent to require payment or imputation of an additional sum, where none was required by the parties, to reflect the "value" of some nebulous "property right" on the order of "the forbearance to demand repayment." The decision below should be reversed in accordance with this practice, and the specific rules necessary to implement the Commissioner's theory should be sought in Congress.

3. The Commissioner has failed to develop his theory fully, leaving numerous technical tax problems to be resolved by the courts. For example, the Commissioner's theory holds that the interest-free portion of an interest-free demand loan constitutes a gift, the value of which is determined by some measure of imputed interest during the period in which no demand for repayment is made. But the Commissioner has shown little inclination to remove from the income tax obligations of the borrower any interest actually received, though this interest clearly should not be taxed to the borrower if it is, as the Commissioner contends, a gift. Section 102(a) of the Internal Revenue Code specifically provides that "[g]ross income does not include the value of property acquired by gift . . ." Although this issue could be addressed by a highly articulated statute of the sort enacted by Congress in the grantor trust area,[2] the Commissioner is currently without such authority. As a result, the Commissioner must contend that the opportunity to receive interest, measured after-the-fact, is property separate and distinct from the interest itself. In other words, according to the Commissioner, the borrower receives two things of value—(1) the opportunity to receive interest, which is subject to the gift tax, and (2) the interest itself, which is subject to the income tax. This is a strange alchemy, which leaves a person loaned $100 at a time when interest rates stand at 20% with $140 at the end of a year.

The Commissioner's ideas as to the interest rate to be used in valuing the "gift" are also half-formed. He has used not only a different rate, but a different standard, in each of *Johnson*, *Crown*, and the case below. The rate and standard argued for now—20% in 1982 and 16% compounded daily in 1983[3]—is well in excess of any rate a borrower could have received on demand funds. It also would have been usurious in many states had it actually been charged by the lender.

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[2] Section 671 *et seq.* of the Internal Revenue Code.

[3] These rates were derived from section 6621 of the Internal Revenue Code, which sets the rate of interest for over- and underpayments of tax. This rate is changed semi-annually.

The Commissioner also cannot explain why the gift and estate tax, unified since 1976, should be higher on, say, $100 loaned on an interest-free demand basis, than it would be on $100 kept in a checking account or $100 given away outright. The tax in the latter two situations would be imposed on $100, and there could be no argument of tax avoidance. The person with his money in the checking account is under no obligation to invest it speculatively so as to increase his estate, and outright gifts are, of course, permitted. But in the case of the loan, using the 20% rate cited by the Commissioner below, the tax would be imposed on $200 if demand for repayment were made after 5 years. Congress could perhaps require such a result, but that question need not be decided here. What is clear is that Congress has not yet specifically undertaken to impose such a tax.

ARGUMENT

I. No Court Has Previously Held That an Interest-Free Demand Loan Could Result in the Receipt of Income or a Gift.

Until the decision below, the Commissioner had never successfully asserted that an interest-free demand loan could result in the receipt by the borrower of income or a gift. In fact, for 47 years after the adoption in 1913 of the first income tax law, and for 42 years after the adoption in 1924 of the forerunner of section 2501(a)(1) and the rest of the gift tax laws, the Commissioner never asserted—let alone successfully—that an interest-free demand loan could produce such tax consequences. This administrative interpretation of the income and gift tax laws was adopted contemporaneously with these laws, by the persons "charged with the responsibility of setting [their] machinery in motion."[4] It was continued throughout the drafting of most of the major regulations implementing these laws.

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[4] *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 315 (1933) (Justice Cardozo). It has been the consistent and salutary practice of this Court to give great weight to the contemporaneous interpretation adopted

(footnote continues)

In 1961, however, in the *Dean* case, 35 T.C. 1083 (1961), the Commissioner did assert that an interest-free loan produced *income* taxable to the borrower. This assertion was rejected by the Tax Court, which held flatly that "an interest-free loan results in no taxable gain to the borrower." 35 T.C. 1083, 1090.

No appeal was pursued in *Dean*, and 12 years passed before there was any public announcement indicating the Commissioner's disagreement. A so-called "non-acquiescence" was published in 1973,[5] however, and an effort was started to overturn *Dean*. In the last four years, this effort has brought at least nine cases to the Tax Court raising questions as to the income taxation of interest-free loans.[6] In these cases, the Commissioner has relied on the broad meaning given to the

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(footnote continued)

by the persons charged with the administration and enforcement of a statute, and to scrutinize closely any assertion that such an interpretation should be upset: "In the construction of a doubtful and ambiguous law, the contemporaneous construction of those who were called upon to act under the law, and were appointed to carry its provisions into effect, is entitled to very great respect." *Edward's Lessee v. Darby*, 25 U.S. (12 Wheaton) 206, 210 (1827). This has been true even where the interpretation arises out of inaction: ". . . just as established practice may shed light on the extent of power conveyed by the general statutory language, so the want of assertion of power by those who presumably would be alert to exercise it, is equally significant in determining whether such power was actually conferred." *Federal Trade Commission v. Bunte Bros.*, 312 U.S. 349, 352 (1941) (Federal Trade Commission first asserted power to regulate certain intrastate transactions 25 years after passage of Trade Commission Act). "Failure to use such an important power for so long a time indicates that the Commission did not believe the power existed." *Federal Power Commission v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513 (1949) (Federal Power Commission had never before asserted right to regulate gas leases).

[5] 1973-2 C.B. 4.

[6] *Baker v. Commissioner*, 75 T.C. 166 (1980); *Parks v. Commissioner*, 40 T.C.M. (CCH) 1228 (1980); *Beaton v. Commissioner*, 40 T.C.M. (CCH) 1324 (1980); *Marsh v. Commissioner*, 73 T.C. 317 (1979); *Greenspun v. Commissioner*, 72 T.C. 931 (1979); *Zager v. Commissioner*, 72 T.C. 1009 (1979); *Creel v. Commissioner*, 72 T.C. 1173 (1979); *Martin v. Commissioner*, 39 T.C.M. (CCH) 531 (1979); and *Suttle v. Commissioner*, 37 T.C.M.

(footnote continues)

term "income" for tax purposes, and the general proposition that Congress intended to exercise its taxing powers fully in the income tax area.[7] Despite this argument, the Commissioner has been uniformly unsuccessful. Although noting that the issue is not free from doubt, the Tax Court has taken notice of the longstanding administrative interpretation preceding *Dean* and the absence of legislation since *Dean*, and has consistently followed *Dean*.

More important, appeals of these cases have been decided against the Commissioner by the First, Second, Fourth, Fifth, Sixth, and Ninth Circuits, again despite the broad meaning given to the term "income" for tax purposes.[8] (The decision of the Sixth Circuit came after that of the court below.) No circuit has decided in favor of the Commissioner. In reaching their decisions, the courts of appeals have taken notice of the Commissioner's change in administrative practice, the passage of twelve years before the public announcement disagreeing with *Dean*, and the reasonable expectation of taxpayers relying on *Dean* and prior administrative practice.

The Commissioner dismissed the *Dean* line of cases, both below and in *Crown*, because they were not gift tax cases. This dismissal is too facile, however, because the crux of both the Commissioner's case and the decision below is the broad

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(CCH) 1638 (1978). A Court of Claims trial judge has recently accepted the Commissioner's theory in *Hardee v. United States*, 82-2 U.S.T.C. (CCH) ¶ 9459 (Ct. Cl. 1982).

[7] *See, e.g., Commissioner v. Lobue*, 351 U.S. 243, 246 (1956); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955) (Congress intended in income tax area to exert "the full measure of its taxing power"); *Commissioner v. Smith*, 324 U.S. 177, 181 (1945) (income is "any economic or financial benefit . . . whatever the form or model by which it is effected").

[8] *Parks v. Commissioner*, 686 F.2d 408 (6th Cir. 1982); *Baker v. Commissioner*, 677 F.2d 11 (2d Cir. 1982); *Commissioner v. Greenspun*, 670 F.2d 123 (9th Cir. 1982); *Beaton v. Commissioner*, 664 F.2d 315 (1st Cir. 1981); *Martin v. Commissioner*, 649 F.2d 1133 (5th Cir. 1981) (affirming *Zager* and *Creel* as well); *Suttle v. Commissioner*, 625 F.2d 1127 (4th Cir. 1980).

meaning given to the terms "gift" and "property" for tax purposes, and the full power Congress intended to exercise in adopting the gift tax laws. This is precisely the argument made —and rejected—as to "income" in the *Dean* line of cases. In fact, it was the Commissioner who argued below that the income and gift taxes were comparable in this regard, citing in support many of the same cases, such as *Glenshaw Glass,* cited by him in the *Dean* cases. In effect then, six courts of appeals have held that, in the absence of legislation, the broad and uncontroverted meaning given to a principal operative tax term is not enough to impose tax consequences in an interest-free loan situation, given a longstanding and contrary administrative interpretation, a beacon case, and the reasonable expectations of taxpayers. One court, the court below, has held the opposite.[9]

To these six courts of appeals can be added a seventh, the court of appeals in *Crown.*[10] Despite arguments by the Commissioner in *Crown* as to the broad meaning given the terms "gift"

[9] It also is expected that the Commissioner will contend that the *Dean* line of cases are unpersuasive because they are based on the so-called "wash" that occurs when a borrower is deemed to realize interest income, but also gets a comparable interest deduction. (There is no such offsetting deduction in the gift tax area.) Both the concurring and dissenting opinions in *Dean,* however, showed that a "wash" would not necessarily occur. As a result, the majority was fully aware that, while it could note the possibility of a "wash," it could not ground its decision on this theory. Criticism of the "wash" theory and its role in *Dean* followed the Tax Court's decision, and the Commissioner used this in the cases succeeding *Dean.* Although the Tax Court acknowledged this criticism and the weakness of the "wash" theory in these cases, it made it clear that efforts to dismiss or distinguish *Dean* and its progeny based on the "wash" theory were not well-founded: ". . . our finding of no taxable income to the taxpayer [in *Dean*] was not grounded on the imputed interest deduction, but rather was based on the conclusion that 'an interest-free loan results in no taxable gain to the borrower.' " *Greenspun v. Commissioner,* 72 T.C. 931, 936.

[10] *See also Wells Fargo Bank, N.A. v. Cory,* 110 Cal. App. 3d 242, 167 Cal. Rptr. 778 (1980), in which the California Court of Appeals held that an interest-free demand loan did not constitute a gift for purposes of that state's gift tax.

and "property" for tax purposes, the court of appeals held that an interest-free demand loan did not result in the receipt of a gift. The court gave great weight to the Commissioner's longstanding and contrary administrative interpretation, the abrupt change in this practice represented by the Commissioner's position in the *Johnson* case, the Commissioner's long delay in announcing his disagreement with *Johnson*,[11] and the retroactive and adverse effect on the reasonable expectations of taxpayers inevitable from a contrary decision. The court also noted that the Commissioner had offered three theories as to why a "transfer of property by gift" could be found to result from an interest-free demand loan, but that two of these—the ones most consistent with the gift tax laws—could not be accurately applied to a demand loan. The court found that the third theory—that the gift is made by serial forebearance—could be accurately applied to a demand loan, but that this theory stretched the gift tax laws to the breaking point. The court below relied on this third theory.

Affirming the decision below, therefore, will mean that this Court believes the tax laws can and should be so "stretched." Such a decision would be contrary to this Court's longstanding practice of giving great weight to the contemporaneous interpretation adopted by the persons charged with a statute's enforcement and contrary as well to the decisions of the Tax Court (the basic court for deciding tax cases, *cf. Dobson v. Commissioner*, 320 U.S. 489 (1943)), a district court, and seven courts of appeal.

II. The Result Desired by the Commissioner Requires Further Legislative Action.

Affirming the decision below will also mean that this Court believes the tax laws should be given an expansive interpretation in an ambiguous situation, *without further action by Congress*. This, too, would be contrary to the decisions of all but

[11] This disagreement was finally announced in Revenue Ruling 73-61, 1973-1 C.B. 408.

the court below. In *Dean* and the subsequent income tax cases, for example, the Tax Court repeatedly urged the Commissioner to seek recourse in Congress, stating that the interest-free loan situation was "peculiarly one that call[ed] for a legislative remedy." *Baker v. Commissioner*, 75 T.C. 166, 170. The decisions affirming these cases also held that any change in this area should be made by Congress, and they were particularly critical of the type of administrative lawmaking advocated by the Commissioner: "Where, as here, the Government seeks to modify a principle of taxation so firmly entrenched in our jurisprudence, it should turn to Congress, not the courts." *Commissioner v. Greenspun*, 670 F.2d 123, 126.[12]

In the gift tax area, both the district court in *Johnson* and the Tax Court in *Crown* and *Dickman* made it clear that more specific congressional authorization was required before the Commissioner could pursue his theory. In affirming *Crown*, the Court of Appeals for the Seventh Circuit also stated that it was "undesirable" to adopt the Commissioner's theory "by judicial construction." 585 F.2d 234, 241.

This Court recently decided a case very similar to this one, in which it held that lunch reimbursement money did not fall within the broad meaning given to the term "wages" for

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[12] Several of these decisions also quoted this Court's discussion of the respective roles of Congress and the judiciary in tax lawmaking:

> Courts properly have been reluctant to depart from an interpretation of tax law which has been generally accepted when the departure could have potentially far-reaching consequences. When a principle of taxation requires reexamination, Congress is better equipped than a court to define precisely the type of conduct which results in tax consequences. When courts readily undertake such tasks, taxpayers may not rely with assurance on what appear to be established rules lest they be subsequently overturned. Legislative enactments, on the other hand, although not always free from ambiguity, at least afford the taxpayers advance warning.

United States v. Byrum, 408 U.S. 125, 135 (1972). Following *Byrum*, Congress exercised its judgment and made the law clear by amending Section 2036(b) of the Internal Revenue Code — with, of course, prospective effect. *See also Helvering v. Griffiths*, 318 U.S. 371, 402-404 (1943), where this Court's decision that the tax law could not properly be construed as the Commissioner wished was followed by congressional action making the law specific.

withholding tax purposes. *Central Illinois Public Service Co. v. United States*, 435 U.S. 21 (1978). In reaching its decision, this Court noted that Congress could clarify such issues if it wanted, but in the meantime the Court could not "justify the Government's attempt to do so by judicial determination." 435 U.S. 21, 33. Justice Powell, in a concurring opinion, pointed out the dangers posed to the reasonable expectations of taxpayers when novel theories were adopted by the Commissioner without clear congressional authorization:

> It seems particularly inappropriate for the Commissioner, absent express statutory authority, to impose retroactively a tax with respect to years prior to the date on which taxpayers are clearly put on notice of the liability . . . In view of the complexities of federal taxation, fundamental fairness should prompt the Commissioner to refrain from the retroactive assessment of a tax in the absence of such notice or of clear congressional authorization.

435 U.S. 21, 38.

The theory of the Commissioner in this case is not only novel and without clear congressional authorization, but contrary to the prior administrative interpretation and the decisions of all but the court below. And it is clear that adoption of the Commissioner's theory will retroactively damage the reasonable expectations of taxpayers, while giving rise to many additional questions requiring "judicial determination." Accordingly, this Court should adopt the approach set forth in *Byrum* and *Central Illinois Public Service*, by requiring specific congressional authorization before permitting the tax urged by the Commissioner to be imposed.

III. Where Interest Is to Be Taken into Account under the Tax Laws, the Internal Revenue Code Is Specific; Moreover, the Courts Have Uniformly Rejected Efforts to Charge or Impute Interest in the Absence of Such Authority.

Congress knows how to tax interest, or to allow for it, when it wishes to do so. The Internal Revenue Code contains dozens of different sections and subsections describing the circumstances under which interest is required, and specifying the

rates to be applied.[13] These include sections where Congress has specifically required that loans carry a "reasonable" rate of interest,[14] and sections where loans will not be permitted or recognized unless no interest or interest at a rate "significantly less" than that prevailing is stated.[15] These also include highly complex sections "creating" interest, or a property right equivalent to interest.[16] These sections are supplemented by lengthy regulations detailing when interest must be charged and at what rates.[17] But there is no such specific section nor regulation supporting the theory pursued by the Commissioner in this case.[18]

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[13] Many of these provisions are listed in Appendix A to this brief. *See also* Note, *Determining Interest under the Internal Revenue Code*, 34 Stan. L.Rev. 639 (1982).

[14] *See, e.g.*, sections 503(b), 503(d)(2), 503(f), and 4975(d).

[15] *See, e.g.*, sections 514(c)(9)(B)(v)(II), 1481(b)(3), and 4941(d)(2)(B).

[16] For example, section 1232 requires taxpayers holding interest-free or low interest bonds to report a portion of the bonds' redemption price as "original issue discount," or interest, over the life of the bonds.

[17] *See, e.g.*, Treasury Regulations § 1.482-2, 26 C.F.R. § 1.482-2, which covers loans between related parties on which either "no interest" or interest "which is not equal to an arm's length rate" is charged. The regulation provides that the Commissioner can impute interest at an arm's length rate, and sets forth 11%, 12%, and 13% simple interest as "safe harbor" rates.

[18] The gift tax law was amended 17 times between its adoption in 1924 and the decision in *Johnson* — that is, during the period when those charged with its adminstration did not believe an interest-free demand loan constituted a gift. The gift tax law has been amended nine additional times since *Johnson*, and three times since *Crown*. *See* Appendix B to this brief. Only a technical corrections act has been adopted since the decision below. Congress must have known during this period that family members and friends often lent each other funds, without charging interest, to meet medical or other emergencies, pay college expenses, make a downpayment on a home, or for other non-business reasons. Congress also must have known that family members let each other "use" property free of charge — as, for example, when an elderly and ailing parent lives out his life with his children. Despite this knowledge, and despite the frequent action taken with respect to the gift tax law, Congress has never seen fit to require that interest be charged on a non-business loan to avoid gift tax consequences. Where a law has received a contemporaneous interpretation by those charged with its administration, where it has been similarly interpreted by the courts, and where it has been

(footnote continues)

Where the Commissioner has tried to impose tax consequences because of the interest-free nature of a transaction without such specific authority, moreover, he has been consistently turned back by the courts.[19] This was perhaps best

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subsequently amended and otherwise acted upon without changing the interpretation of the administrators or courts, the "reenactment" rule is properly applied. *See, e.g.*, Sutherland on Statutory Construction, § 49.09 (4th Ed. 1973); *Lorillard v. Pons*, 434 U.S. 575 (1978); *Shapiro v. United States*, 355 U.S. 1 (1948).

[19] *See, e.g., Tennessee-Arkansas Gravel Co. v. Commissioner*, 112 F.2d 508 (6th Cir. 1940) and *Smith-Bridgman & Co. v. Commissioner*, 16 T.C. 287 (1951), acq. 1951-1 C.B. 3, and compare them to *B. Forman Co. v. Commissioner*, 453 F.2d 1144 (2d Cir.), *cert. denied*, 407 U.S. 934 (1972) (decided after Congress granted the Commissioner authority to issue regulations imputing interest on interest-free or low-interest transactions between related parties under section 482 of the Internal Revenue Code). *See also Lupowitz Sons, Inc. v. Commissioner*, 497 F.2d 862 (3d Cir. 1974); *Saunders v. United States*, 294 F.Supp. 1276 (D. Hawaii 1968), *rev'd* on another issue, 450 F.2d 1047 (9th Cir. 1971); *Brandtjen & Kluge, Inc. v. Commissioner*, 34 T.C. 416 (1960); *Society Brand Clothes, Inc. v. Commissioner*, 18 T.C. 304 (1952); and *Combs Lumber Co. v. Commissioner*, 41 B.T.A. 339 (1940).

Nor are *Berkman v. Commissioner*, 38 T.C.M. (CCH) 183 (1979) or *Blackburn v. Commissioner*, 20 T.C. 204 (1953), the cases relied on by the court below, to the contrary. *Berkman* and *Blackburn* involved low-interest *term* loans, not loans payable on demand. Although the court below deemed these two types of loans equivalent, this is obviously incorrect. Even the commentators who are critical of *Crown* acknowledge that a demand loan, enforceable at once and at will, is more like a revocable trust and is clearly different from a term loan. *See, e.g.*, Joyce & Del Cotto, *Interest Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459, 460 (1981) (in contrast to a term loan, a demand loan "is a completely revocable transaction, and, since the borrower never receives the right to use the money for any particular time, it could be properly viewed as no loan at all"). The Commissioner also admitted below that demand and term loans are different, both as to timing and value. Perhaps the most important difference is that a demand loan is worth face value at any given moment. A term loan, in contrast, may be worth less or more than face, based on its interest rate or the length of its term. This means that the note given in a term loan situation might be worth less than the cash or property received in exchange. But the Commissioner has long had specific statutory authority with respect to such unequal exchanges. *See, e.g.*, section 2512(b) of the Internal Revenue Code. (The Commissioner's attempt to apply this particular section to a demand loan was rejected in *Crown*, and was not adopted by the court in reaching its decision below.)

seen in the installment sale area, where the Commissioner was unsuccessful in arguing that a person selling goods over time on an interest-free basis could be charged with the receipt of interest. *See, e.g., Brown v. Commissioner,* 37 T.C. 461 (1961), *aff'd,* 325 F.2d 313 (9th Cir. 1963), *aff'd,* 380 U.S. 563 (1965); *Pretzer v. United States,* 61-1 U.S.T.C. (CCH) ¶ 9477 (D. Ariz. 1961). The Commissioner took his concern to Congress, which thereafter added section 483 to the Internal Revenue Code.[20] This section authorizes the Commissioner to characterize as interest a portion of the sale price in an installment transaction, if interest below a specified rate is not required by the parties. But section 483 also provides a detailed set of rules guiding and limiting the Commissioner—as the decision below cannot. Section 483 provides, for example, that no interest may be imputed if the installment transaction is of less than a year's duration or involves less than $3,000. Section 483 also sets forth the exact interest rate to be used when interest may be imputed. The Commissioner has claimed that he can achieve similar results in the interest-free loan situation through administrative grace, but the wisdom and efficiency of this is open to question. (The Commissioner has already used three different interest rates and three different standards in the three cases litigated to date.)

In sum, affirming the decision below would be contrary to the very specific approach to interest adopted throughout the Internal Revenue Code, and would be contrary to the wide respect granted by the courts to this approach. Affirming the decision below will also foster much additional litigation, while the courts develop guidelines and limits which would be better provided by prospective statute and regulations.

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[20] The Commissioner has since issued over 50 pages of regulations detailing the application of section 483. Treasury Regulations § 1.483, 26 C.F.R. § 1.483.

IV. The Gift Tax Theory Offered by the Commissioner and Accepted Below Is Not Fully Developed, and Creates Both Inconsistencies in Tax Law and New Issues Requiring Litigation.

A. *If the loan is a gift, there should be no income to the borrower.* Under federal tax law, the recipient of a gift is not subject to income taxation on that gift.[21] Accordingly, if an interest-free demand loan is treated as a gift because the funds borrowed can be used to earn interest or other income without obligation to the lender, the borrower should not be subject to income taxation on the interest or other income so earned, since this is precisely the benefit alleged to be received by gift. Even those commentators who contend that interest-free loans constitute gifts admit that taxing the borrower on such interest or other income is a distortion of existing law. Some of these commentators believe the Commissioner can "expand" the law to reallocate this interest or other income to the lender, but most believe legislation is needed.[22]

Perhaps because such legislation has not been obtained, the Commissioner has not seen fit to relieve the borrower of income taxation with respect to such interest or other income. To rationalize this in the face of the clear rule to the contrary set forth in section 102(a) of the Internal Revenue Code, the Commissioner maintains that the opportunity to receive interest, obtained in an interest-free loan, is separate and distinct, with a separate value, from the interest or income, if any, actually earned. Taken to its logical conclusion, this means that a person (1) holding the right to receive interest, valued as it was by the Commissioner below using a rate of 20%, and (2) actually receiving interest at 20%, is wealthier by 40%—since he has received interest of 20%, and, on the Commissioner's theory, has also received a gift of 20%.

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[21] Section 102(a) of the Internal Revenue Code provides: "Gross income does not include the value of property acquired by gift . . ."

[22] Roth, *Can Lender Be Charged with Receiving Taxable Income as a Result of an Interest-Free Loan?*, 52 J. Tax. 136 (1980); Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L.Rev. 459 (1979-1980); Frazier, *Interest-Free Loans between Family Members: What Practitioners Can Expect after Crown*, 48 J.Tax. 28 (1978); Note, *Gift Taxation of Interest-Free Loans*, 19 Stan. L.Rev. 870 (1967).

One need not rely on this example, however, to show that the Commissioner is wrong in his contention that the opportunity to use money or property is separate and distinct from the interest or other income actually earned. Prior to the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, taxpayers could donate cash or property to a charity for a term and receive a "double benefit"—they could (1) exclude the income derived from the property during the term, and (2) take a charitable contribution deduction for the value of the term.[23] The Commissioner presented to Congress the argument that such taxpayers were getting a "double benefit," since they excluded income from the property during the term, and also received a

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[23] This practice was accepted in *Abbott v. United States*, 74-2 U.S.T.C. (CCH) ¶ 13040 (S.D. Miss. 1974) (right to use property for the life of another); *Thriftimart, Inc. v. Commissioner*, 59 T.C. 598 (1973) (leasehold terminable on sale of building); *Allen v. Commissioner*, 57 T.C. 12 (1971) (term leasehold); *Threlfall v. United States*, 302 F.Supp. 1114 (W.D. Wisc. 1969) (term leasehold); *Passailaigue v. United States*, 224 F.Supp. 682 (M.D. Ga. 1963) (use of property terminable on fifteen days notice, treated by the court as equivalent to *Sullivan, infra*); and *Sullivan v. Commissioner*, 16 T.C. 228 (1951) (right to use property for duration of war). These cases were central to the decision below, which cited them to prove that the use of property itself constituted property, which could then be subject to gift taxation. But reliance on these cases was misplaced. *First*, these cases involved charitable deductions, and the operative statute in each required only a "contribution," not a "transfer of property by gift." *Second*, the Commissioner and the Congress have agreed that the cases involved a "double counting" of the property involved. *Third*, and perhaps most important, the court below failed to distinguish between a contribution for a term, and one subject to demand. Noting that some of the cases involved contributions for *indefinite* terms (for example, property contributed for the duration of the war), the court below concluded that such arrangements were the equivalent of contributions subject to demand. But this conclusion is unwarranted, because the donor is not in control of the duration of the contribution when property is transferred for an indefinite term, but he is in continuous control when the arrangements are subject to demand. This distinction — whether or not the donor is in control — is important throughout federal tax law and regulations. Compare, for example, Treasury Regulations § 25.2512-5(c), 26 C.F.R. § 25.2512-5(c), which treats a transfer of the right to use property for the life of another as a gift, with Treasury Regulations § 25.2511-2(b), 26 C.F.R. § 25.2511-2(b), which shows that a transfer to a grantor or revocable trust is not.

deduction for the gift.[24] Congress agreed that "the right to use the property . . . represent[s] the equivalent of the rental income from the property," and passed legislation to eliminate the "double benefit."[25]

For the same reason, the Commissioner is "double counting" when he treats the borrower of an interest-free demand loan as the recipient of both a gift and of income on the funds borrowed. As in the case of the "charitable contribution of property for a term," the Commissioner should recognize that his tax theories need further development—and legislation— to correct this distortion.

B. *There is no clear basis on which a court can determine the amount of the "gift."* The Commissioner has no coherent theory as to the amount of the "gift," if any, in this situation, nor has he produced any evidence as to the "amount" which he claims should be treated as a "gift." He prefers instead to use "safe harbor" rates, although he has no statutory authority for this. Indeed, he has used three different rates and three different standards in *Johnson, Crown,* and the case below. In *Johnson,* he used 3½% and the method prescribed in Treasury Regulations § 25.2512-5 for valuing annuities, life interests, and remainder interests.[26] In *Crown* he used 6%, based on the prevailing prime rate. In the court below, he used rates up to 20%, as determined under section 6621.

It was clear in the case below, however, that 20% exceeded any return the borrower could have earned on demand funds, since saving accounts were paying approximately 4½% to 6%

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[24] *See* Griswold, *Charitable Gifts of Income and the Internal Revenue Code,* 65 Harv. L.Rev. 841 (1951).

[25] H. Rep. No. 91-413, 91st Cong., 1st Sess. 58 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 83-84 (1969); sections 170(f)(3)(A) and 2522(c) of the Internal Revenue Code. Section 170(f)(3)(A) eliminates the contribution deduction for income tax purposes, while section 2522(c)(2) eliminates the gift tax deduction. Section 2522(c)(2) poses another technical problem for the Commissioner's gift tax theory: An interest-free loan to a charity would constitute a gift, but there would be no offsetting gift tax deduction to prevent imposition of the gift tax.

[26] 26 C.F.R. § 25.2512-5.

and checking accounts, if interest-bearing, were paying slightly less. Moreover, the Commissioner admitted in *Crown* that the appropriate interest rate and method would vary according to the facts and circumstances, including those particular to the lender and borrower and those concerning general economic trends. The additional litigation this will foster is obvious.[27]

Nor is it correct to argue that imposition of the gift tax will eliminate interest-free demand loans, so that the additional litigation predicted is hypothetical. The gift tax theory accepted by the court below applies not only to interest-free loans, but to loans bearing interest at either too low or too high a rate. For example, a loan bearing a 5½% interest rate, equal to the rate on savings accounts, would constitute a gift if the Commissioner's 20% rate and method are correct. Conversely, a loan bearing a rate of, say, 23%, would constitute a gift by the borrower to the lender. In the absence of statutory guidelines, therefore, all loans not clearly in a business context—that is, all loans between family members, friends, and so on—would be subject to gift taxation.[28] This will make it impossible for such persons to make normal arrangements for emergencies in their families, or otherwise to plan their affairs.

C. *The Commissioner's theory taxes the same value twice.* Finally, the Commissioner's gift tax theory produces an additional, significant distortion: the gift tax on an amount lent to another can be greater than either the gift tax on the same

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[27] As previously noted, the court below remanded to the Tax Court for further proceedings concerning the appropriate interest rate and method.

[28] The problems inherent in determing whether an interest-free demand loan constitutes a gift, and in what amount, are apparent when one does consider the familial and friendly context in which such loans are usually made. Suppose, for example, that a father makes an interest-free loan to an adult daughter for the purpose of helping her in buying a house. The funds come from the father's checking account, where they would not otherwise be used. Or, suppose that a son makes an interest-free loan to his parents to help them meet emergency medical bills. Or suppose that an adult son in college is arrested, and the father makes an interest-free loan to him in order that he may arrange bail. How is the existence and value of the "gift" to be determined in such cases? Would it make any difference if the loan were made at a substantial rate of interest, say 10%, but less than the 20% rate which the Commissioner advances in this case?

amount *given outright*, or the unified gift and estate tax on the same amount *retained*. This results from the fact that the "value" of property reflects, in part, the capacity of property to produce income. Thus, taxing the property and also the income it has the capacity to produce taxes the same "value" twice. As a result, affirming the decision below will cause those who have made interest-free demand loans—in reliance on the Commissioner's administrative practice, *Johnson* and *Crown*, or the absence of specific statutory authority—to be charged with a large and retroactive expansion of their gift and estate tax obligations. This will be so even though these persons will not have and never have had the funds "represented" by this expansion, and would not be required to generate such funds had they never made the interest-free loans. In other words, these persons could have made an outright gift of, say, $100, and paid tax on that $100. They would not have been taxed on any amount they could have earned on the $100, or that the donee did earn on that $100. Or they could have kept the $100 —in a checking account, a safety deposit box, an investment that "breaks even," or the proverbial mattress—and paid tax on only the $100. Again, they would not have been taxed on any amount they could have earned on the $100.[29] But if the $100 is lent on an interest-free demand basis to a family member, the tax may be imposed on $120, $140, or more, depending on the time the loan is outstanding.[30] Such a system does not make sense on its face, and should not be sanctioned by this Court in the absence of additional congressional authorization.

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[29] Although substantial funds are kept in checking accounts, safety deposit boxes, and the like, one does not need to hypothesize funds held in a non-income producing manner to illustrate the distortions caused by the Commissioner's theory. Many persons keep funds in secure, but low-interest paying, government obligations. If a person held $100, for example, in a 6% U.S. Savings Bond and died one year later, the unified gift and estate tax would be imposed on $106. If this same person lent this $100 to a family member on an interest-free demand basis and died one year later, the unified gift and estate tax would be imposed, according to the Commissioner, on $120.

[30] In this case the principal of the amount of the loan was included in the lender's taxable estate, and tax was paid on it.

In sum, the Commissioner's still-developing gift tax theory (1) contravenes existing law by subjecting gifts to income taxation, (2) "double counts" as to interest earned, (3) offers little guidance regarding appropriate interest rates to persons lending money to family or friends, and (4) results in retroactive and distortedly high gift and estate taxes on interest-free loans. If recourse to Congress is not required, correcting and limiting these anomalies will require many additional court decisions.

CONCLUSION

In concurring in the opinion below, Judge Fay stated, "Taxpayers have given away no property, no interests, and no rights, but surely they have made a gift." 690 F.2d 812, 820. This remark captures perfectly the belief of the court below, shared by many commentators, that "something" of value is being transferred when a lender forbears to demand repayment of an interest-free demand loan. But it captures equally well the difficulty of conforming this "something" with the gift tax laws, which require "a transfer of property by gift" before a tax may be imposed. Here the only "transfer" of "property" was of the money loaned, but that transfer and that property are not what the Commissioner seeks to tax—and rightly so, for that transfer was not a "transfer of property by gift," as the statute requires, but was a "transfer of property by loan."

Moreover, the Commissioner made no claim for almost fifty years following passage of the income and gift tax laws that the "something" to which Judge Fay alludes produced either income or gift tax consequences. The Tax Court, a district court, and seven courts of appeals have agreed that no such consequences can attach, in the absence of additional and specific legislation shaping and limiting this "something." Congress has frequently enacted such legislation in other situations, describing, for example, the circumstances under which interest must be charged or imputed and the exact rates to be used. This practice is much preferable to retroactive taxation imposed by judicial decision, particularly when based, in whole or part, on the elusive notion that "something" is being transferred.

Accordingly, the decision below should be reversed, and the Commissioner should be barred from imposing gift tax liability until legislation is obtained making clear the intent of Congress, and resolving the many questions which are implicit in the Commissioner's wholly theoretical claim to a tax.

Respectfully submitted,

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May, 1983

APPENDIX A

INTERNAL REVENUE CODE SECTIONS WHERE CONGRESS HAS LEGISLATED WITH RESPECT TO INTEREST AND INTEREST RATES

Internal Revenue Code Section	Interest Rate Specified	Subject
101(d)(2)(B)(ii)	Rate used by the insurer in calculating policy payments	Certain insurance calculations
101(f)(2)(B)	Greater of 6% annual effective rate or minimum rate in insurance policy	Certain insurance calculations
101(f)(2)(C)	Greater of 4% annual effective rate or minimum rate in policy	Certain insurance calculations
103A(i)(2)	Not greater than 1.25% in excess of bond yield	Mortgage subsidy bond
103A(1)(8)	Actuarial basis, taking into account present value of money	Mortgage subsidy bond
163(b)	6% of average unpaid balance	Failure to state interest in installment purchase
167(q)	Average adjusted prime for a preceding six month period	Failure to retire certain boilers
168(i)(5)	Not greater than average adjusted prime for a preceding six month period	Limitation on interest paid in safe harbor lease
263(g)	Calculated by complex formula	Interest in the case of straddles
404A(g)(3)	20% above or below average rate on long-term corporate bonds	Permissible range of interest in foreign deferred compensation plans
411(a)(7)(C)	5% compounded annually	Interest on accrued benefit in pension and other plans

Internal Revenue Code Section	Interest Rate Specified	Subject
411(c)(2)(C)	5% compounded annually	Interest on accumulated contributions of interest on accrued benefit in pension and other plans
412(b)(5)	Appropriate rate consistent with plan rate	Minimum funding standards for pension and other plans
412(c)	Based on reasonable actuarial assumptions	Minimum funding standards
415(b)(2)(E)(i)	Not less than the greater of 5% or plan rate	Limitations on qualified plans
415(b)(2)(E)(ii)	Not greater than the lesser of 5% or plan rate	Limitations on qualified plans
483(b)	By regulation, currently 10% (unless 9% stated)	Unstated interest on deferred payments
483(g)	Not greater than 7% compounded semi-annually	Unstated interest on certain land transfers between related parties
503(b)	Reasonable rate	Loans by exempt organizations
503(d)(2)	Reasonable rate if payable on demand	Loans by certain qualified trusts
503(f)	Reasonable rate	Loans by certain qualified trusts to employees
514(c)(9)(B)(v)	Significantly less than rate otherwise available	Certain loans to exempt organizations
668	6% times complex formula	Interest charged on accumulation distributions from foreign trusts

Internal Revenue Code Section	Interest Rate Specified	Subject
801(b) and (g)	Assumed rates	Certain life insurance calculations
805(c)	Average rate assumed in calculating reserves	Calculation of life insurance reserve adjustments
805(f)	Calculated by complex formula	Calculation of guaranteed qualified interest
809(a)	Calculated by complex formula	Life insurance investment yield
1232	Generally difference between issue price and redemption price	Original issue discount on bonds and other indebtedness
1232A	Generally difference between issue price and redemption price, at "constant rate of interest"	Original issue discount on new issues
1232B	Generally difference between issue price and redemption price, at "constant rate of interest"	Original issue discount on stripped bonds
1397(b)	Average adjusted prime rate for a preceding six-month period	Rules applicable to an electing GSOC
1481(b)(3)	No interest may be charged	Renegotiation of government contracts
2032A(e)	Average annual effective rate for all new Federal Land Bank loans	Valuing farm
3451(b)	Assume whole payment is interest under certain circumstances, by regulation	Withholding on periodic payments
3452(d)	Not in excess of $150	Calculation of exemption for "minimal interest"

Internal Revenue Code Section	Interest Rate Specified	Subject
3554	Amount actually paid	Definition of interest whether or not designated as such
4941(d)(2)(B)	No interest may be charged	Certain loans to private foundations
4975(d)	Reasonable rate	Exemption from excise tax for certain loans
6049(b)	Amount actually paid	Definition of interest whether or not designated as such
6166(f)	Average adjusted prime rate for a preceding six-month period	Tax payment extension in case of closely-held business
6167(e)	Average adjusted prime rate for a preceding six-month period, payable annually	Tax extension in case of foreign expropriation loss
6332(b)	Contractual rate	Tax levies
6332(c)	Average adjusted prime rate for a preceding six-month period	Tax levies
6335(e)(3)	6% per annum	Deferral of payment in sale of seized property
6337(b)(2)	20% per annum	Redemption of property after levy
6601	Average adjusted prime rate for a preceding six-month period	Interest on underpayments
6602	Average adjusted prime rate for a preceding six-month period	Interest on erroneous refunds
6611	Average adjusted prime rate for a preceding six-month period	Interest on overpayments

Internal Revenue Code Section	Interest Rate Specified	Subject
6621	Average adjusted prime rate for a preceding six-month period	Interest determination for various tax purposes
6622	Average adjusted prime rate for a preceding six-month period	Compounding rule
7426(g)	Average adjusted prime rate for a preceding six-month period	Civil actions against wrongful levy
7506(d)	1% per month	Real estate administered by U.S.
9501(c)	Current average market yield on U.S. obligations	Black lung repayable advances

APPENDIX B
ACTS AMENDING GIFT TAX LAW*

Technical Corrections Act of 1982, P.L. 97-448, 96 Stat. 2365.

Economic Recovery Act of 1981, P.L. 97-34, 95 Stat. 172.

Revenue Act of 1978, P.L. 95-600, 92 Stat. 2763.

Tax Reform Act of 1976, P.L. 94-455, 90 Stat. 1520.

Internal Revenue Code Amendments of 1974, P.L. 93-625, 88 Stat. 2108.

Excise, Estate, and Gift Tax Adjustment Act of 1970, P.L. 91-614, 84 Stat. 1836.

Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487.

Foreign Investors Tax Act of 1966, P.L. 89-809, 80 Stat. 1539.

Tax Treatment of Certain Payments, 1966, P.L. 89-365, 80 Stat. 32.

Self-Employed Individuals Tax Retirement Act of 1962, P.L. 87-792, 76 Stat. 809.

Internal Revenue Amendments, 1960, P.L. 86-779, 74 Stat. 998.

Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606.

Internal Revenue Code of 1954, ch. 736, 68A Stat. 1.

Revenue Act of 1951, ch. 521, 65 Stat. 452.

Powers of Appointment Act of 1951, ch. 165, 65 Stat. 91.

Revenue Act of 1950, ch. 994, 64 Stat. 906.

Technical Changes Act of 1949, ch. 720, 63 Stat. 891.

Revenue Act of 1948, ch. 168, 62 Stat. 210.

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* *See also* Montgomery, Wynn & Blattmachr, Federal Taxes—Estates, Trusts, and Gifts, ch. 19 (1952).

Revenue Act of 1942, ch. 619, 56 Stat. 798.

Revenue Act of 1941 ch. 412, 55 Stat. 687.

Revenue Act of 1940, ch. 419, 54 Stat. 516.

Internal Revenue Code of 1939, ch. 2, 53 Stat. 1.

Revenue Act of 1938, ch. 289, 52 Stat. 447.

Revenue Act of 1935, ch. 829, 49 Stat. 1014.

Revenue Act of 1932, ch. 209, 47 Stat. 169.

Revenue Act of 1926, ch. 27, 44 Stat. 9.

Revenue Act of 1924, ch. 234, 43 Stat. 253.

No. 82-1041-CFX
Status: GRANTED

Title: Esther C. Dickman, et al., Petitioners
v.
Commissioner of Internal Revenue

Docketed:
December 17, 1982

Court: United States Court of Appeals
for the Eleventh Circuit

Counsel for petitioner: Riggs, Frank P.

Counsel for respondent: Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Dec 17 1982	G	Petition for writ of certiorari filed.
2	Jan 24 1983		Brief of respondent Commissoner of Internal Revenue in support of petition filed.
3	Jan 26 1983		DISTRIBUTED. February 18, 1983
4	Feb 22 1983		Petition GRANTED.
			**********
5	Mar 10 1983		Record filed.
6	Mar 6 1983	G	Motion of the parties to dispense with printing the joint appendix filed.
7	Mar 11 1983		DISTRIBUTED. March 18, 1983. (Above motion)
9	Mar 21 1983		Motion of the parties to dispense with printing the joint appendix GRANTED.
11	Mar 21 1983		Order extending time to file brief of petitioner on the merits until May 9, 1983.
12	May 6 1983		Brief amicus curiae of D'Ancona & Pflaum filed.
13	May 5 1983		Brief amicus curiae of Jones, Day, Reavis & Pogue filed.
14	May 6 1983		Brief of petitioners Esther C. Dickman, et al. filed.
15	May 12 1983	D	Motion of D'Ancona & Pflaum for leave to participate in oral argument as amicus curiae filed.
16	May 13 1983	D	Motion of petitioners for divided argument filed.
18	May 31 1983		Motion of D'Ancona & Pflaum for leave to participate in oral argument as amicus curiae DENIED.
20	Jun 2 1983		Order extending time to file brief of respondent on the merits until July 8, 1983.
21	Jun 13 1983		Motion of petitioners for divided argument DENIED.
23	Jul 8 1983		Order further extending time to file brief of respondent on the merits until July 22, 1983.
24	Jul 22 1983		Brief of respondent filed.
25	Aug 2 1983		CIRCULATED.
26	Sep 21 1983		SET FOR ARGUMENT. Tuesday, November 1, 1983. (2nd case) (1 hour)
27	Oct 19 1983	X	Reply brief of petitioners Esther C. Dickman, et al. filed.
28	Nov 1 1983		ARGUED.